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In the matter of:

Digital Performance Right in
Sound Recording and Ephemeral
RecordingDocket No.
2000-9CARP DTRA
1 & 2Conference Room 216
Second Floor
Offices of Arnold & Porter
555 12th Street, N.W.
Washington, D.C.Wednesday,
October 24, 2001

The above-entitled matter came on for rebuttal
hearing, pursuant to notice, at 9:00 a.m.

BEFORE

THE HONORABLE ERIC E. VAN LOON	Chairman
THE HONORABLE JEFFREY S. GULIN	Arbitrator
THE HONORABLE CURTIS E. von KANN	Arbitrator

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C-O-N-T-E-N-T-S

WITNESS DIRECT CROSS REDIRECT RECROSS

George Schink

By Mr. Garrett 13531
By Mr. Rich 13615
By Mr Joseph 13706

Voir Dire by Mr. Rich on page 13534

Steve Marks

By Mr. Katz 13772
By Mr. Steinthal 13841

EXHIBIT DESCRIPTION MARK RECD

SERV REBUTTAL

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1 P-R-O-C-E-E-D-I-N-G-S

2 (9:04 a.m.)

3 CHAIRMAN VAN LOON: Well, good morning
4 everyone. We're especially pleased to have this air
5 conditioned hospitality this morning given what we're
6 understanding may be a record break temperature
7 outside. So glad to be here.

8 Welcome. We're pleased to have you with
9 us this morning.

10 Let me ask if counsel initially whether
11 there are any procedural and administrative matters.
12 If not, we'll hear from our witness.

13 MR. GARRETT: Let me just report, Your
14 Honor, that we reached agreement on Mr. Greenstein,
15 the other Mr. Greenstein as to the wording of the
16 affidavits.

17 CHAIRMAN VAN LOON: Excellent.

18 MR. GARRETT: And they are being checked
19 over and executed, and we should have them on file
20 this afternoon sometime.

21 And we also reached with Mr. Greenstein as
22 to the portions of the transcript that could be shared

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1 with Mr. Marks.

2 CHAIRMAN VAN LOON: Oh, good. So the
3 panel could expect to have affidavits in hand sometime
4 after the lunch break?

5 MR. GARRETT: I'm shooting for that, Your
6 Honor. They just -- I think they've all been typed up
7 now in final form and they should be executed.

8 CHAIRMAN VAN LOON: Uh-huh.

9 MR. GARRETT: And I think everybody is in
10 town and available to sign them.

11 CHAIRMAN VAN LOON: In that case, we're
12 pleased to welcome you to be with us this morning.
13 Let me ask you initially, please, to raise your right
14 hand to be sworn in by our court reporter.

15 And I believe, Mr. Garrett, you have some
16 direct.

17 MR. GARRETT: Yes, I do, Mr. Chairman.

18 Before I do, let me just hand out copies
19 of the slides that Mr. Schink will be using.

20 I believe we can start in open session,
21 but at some point we will need to move into restricted
22 session.

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1 Whereupon,

2 GEORGE R. SCHINK

3 was called as a witness by Counsel by RIAA and having
4 been first duly sworn, assumed the witness stand and
5 was examined and testified as follows:

6 DIRECT EXAMINATION

7 BY MR. GARRETT:

8 Q Dr. Schink, would you state and spell your
9 name for the record, please?

10 A My name is George R. Schink. Last name
11 is spelled S-C-H-I-N-K.

12 Q What is your current position?

13 A My position is Director at a LACG, which
14 is an economic and financial consulting firm.

15 Q Briefly describe your educational
16 background?

17 A Yes. I was awarded a bachelor of science
18 degree in economics at the University of Wisconsin,
19 Madison and a Ph.D. degree in economics from the
20 University of Pennsylvania in Philadelphia in 1971.

21 CHAIRMAN VAN LOON: Let me ask you, too,
22 Dr. Schink, if you could make efforts to keep your

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1 voice up because the panel and the people in the back
2 of the room and the court reporter. We're all
3 interested in what you have to say.

4 THE WITNESS: I will try to do so.

5 CHAIRMAN VAN LOON: Thank you.

6 BY MR. GARRETT:

7 Q You've had some teaching experience, Dr.
8 Schink?

9 A Yes, when I left graduate school I taught
10 for four years at the University of Maryland at
11 College Park. During the last three years I was there
12 I also was at the Brookings Institution. From there
13 I went to -- Forecasting Associates in Philadelphia
14 which at that time was a nonprofit research group.
15 And I stayed there for 16 years and held various
16 positions, and was senior Vice President for
17 Consulting when I left.

18 I left in 1988 to set up my own firm in
19 conjunction with another, and ran that for six years.
20 And then moved to Washington and joined LECG, where
21 I've been since.

22 Q Okay. Briefly describe your experience

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1 with regulatory economic issues?

2 A I've been involved in regulatory economics
3 matters for a number of years. My work has included,
4 among other things, work on both the level of rates
5 and the relative rates that should be charged in the
6 arenas. And I've worked in electric, and gas, and
7 pipeline and cable, telecommunication; the whole
8 gambit of industries.

9 Q Briefly describe your experience with the
10 music and the media industries?

11 A Yes. I have -- I worked for a number of
12 groups within the media industry. I've worked with the
13 National Association of Broadcasters. I've worked for
14 an association of local broadcasters in the first CARP
15 that dealt with the distribution of cable royalties.
16 I've worked for cable companies, and I've also done
17 work for RIAA consulting with them on matters related
18 to mechanical rates and also to the rates in this
19 matter.

20 Q Would you briefly describe your experience
21 with statistical analysis and survey evidence?

22 A Yes. One of my major fields as a graduate

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1 student was econometrics, which is the application of
2 statistics to economic data and problems. My thesis
3 a very detailed statistical analysis. I have been
4 involved in doing statistical and econometric research
5 throughout my career. I've testified on it several
6 times. And in fact, the issue that I testified on in
7 the first CARP was of a statistical nature.

8 Regarding surveys, I have been involved in
9 the design of several surveys and have interpreted the
10 results of the others, and have testified about both
11 the construction, the results of surveys before
12 regulatory bodies.

13 MR. GARRETT: I offer the witness for voir
14 dire at this point.

15 MR. RICH: A couple of questions.

16 VOIR DIRE

17 BY MR. RICH:

18 Q Good morning. Is it Dr. Schink?

19 A Yes, well I have a Ph.D., yes.

20 Q Good morning, Dr. Schink. I'm Mr. Bruce
21 Rich representing Services Esquire in this proceeding.

22 You've written and testified extensively

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1 over the course of your career, is that right?

2 A That's correct.

3 Q Can you identify which of your writings
4 has pertained to any aspect of the music business?

5 A You mean published articles?

6 Q Yes.

7 A I have not published articles on the music
8 business.

9 Q And can you identify which of your
10 testimony prior to today and the submission of your
11 written rebuttal testimony in this proceeding has
12 pertained to any aspect of the music business?

13 A Testimony. I've testified on media issues,
14 not music issues.

15 Q Not music issues?

16 And was your only prior involvement with
17 respect to the music industry or music licensing
18 advice the consultative role which you describe at the
19 top of page 2 of your testimony that is in relation to
20 advising the RIAA in mechanical rate negotiations with
21 the music publishers regarding physical recordings and
22 digital downloads?

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1 A Prior to this matter, yes.

2 Q Prior to this. And were you retained
3 approximately with respect to this matter?

4 A My first work related to this matter was
5 with the RIAA before negotiations started with the
6 parties and involved an on again/off again, depending
7 on issues, as issues arose basis since then.

8 Q And so approximately what time period
9 would that have entailed?

10 A I guess, it's been over two years.

11 Q And generally what has been the nature of
12 the advice which the RIAA has sought from you and
13 which you have provided?

14 A Well, one of the things I did was looked
15 at how royalties were done in other markets. And I've
16 also advised them during negotiations -- or helped
17 them understand proposals during the negotiation
18 process. I helped them evaluate proposals during the
19 negotiation process.

20 Q And when you say you examined royalties in
21 other markets, so what markets are you referring to?

22 A I think we looked into varying degrees of

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1 how royalties were calculated in broadcast radio and
2 other fields. It's been some time and I haven't looked
3 at that result -- the work for some time. But we tried
4 to look at as many markets or as many areas -- we
5 tried to look at as many markets as we could. I can't
6 remember exactly how many we looked at at that time.

7 Q When you say "we," who is the we?

8 A Myself and my colleagues at LECG.

9 Q And did you prepare any form of written
10 product or written opinion product in relation to the
11 consultations and advice you've just testified to?

12 A There probably were some memos written. I
13 don't recall at this point.

14 Q And did you personally author any memos
15 associated with that consultation?

16 A I probably did. I can't recall as I stand
17 here. it's been a while.

18 Q Were you asked at any point to provide
19 testimony in connection with the direct phase -- you
20 realize we have had two phases of this proceeding, and
21 that this is the rebuttal phase?

22 A That's correct. I was not asked before.

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1 MR. GARRETT: When you say "you," are you
2 referring to LECG or Dr. Schink?

3 MR. RICH: This witness personally.

4 MR. GARRETT: Okay.

5 BY MR. RICH:

6 Q And the answer is no?

7 A No, I was not asked.

8 Q And when were you first approached about
9 providing the substance of the testimony which now
10 appears as the rebuttal testimony?

11 A Oh, I think probably a month before
12 testimony was filed, something in that order.

13 Q Thank you.

14 MR. RICH: I have nothing for him.

15 CHAIRMAN VAN LOON: Mr. Garrett?

16 BY MR. GARRETT:

17 Q Dr. Schink, turning to page 2 of your
18 written testimony, briefly describe the purpose of
19 your testimony here today?

20 A Yes. This panel asked that the RIAA
21 evaluate or examine Professor Jaffe's proposed
22 benchmark approach and to make whatever adjustment it

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1 deemed appropriate to that approach. And my testimony
2 essentially responds to the panel's request.

3 Q On page 3 of your testimony you describe
4 certain concerns that you have with Dr. Jaffe's
5 approach, correct?

6 A That's correct.

7 Q Let me ask you to turn to the first of
8 those concerns and briefly describe that?

9 A Professor Jaffe purports to use the
10 broadcast radio musical works license fee as his
11 benchmark, which is stated in a percentage of net
12 review terms. But instead of him using the benchmark
13 as it actually has been negotiated in markets, he
14 converts it to a per performance type fee, which I
15 think is inappropriate.

16 Q So you've made certain adjustments to
17 that?

18 A And in my own analysis I've made the
19 adjustment to use the license fee as it in fact has
20 been negotiated in market in percentage terms.

21 Q All right. Secondly, you talk about the
22 differences between sound recordings and musical works

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1 as another concern you had with Dr. Jaffe analysis.
2 Could you briefly describe that concern?

3 A Yes. Professor Jaffe assumes that the
4 appropriate license fees for musical works and sound
5 recordings are essentially the same, that there is no
6 reason to charge rates that are different. In fact,
7 what I have done is to analyze that claim and I have,
8 in fact, concluded that there are reasons for them to
9 be different.

10 Q And finally you talk about a downward
11 promotional benefit adjustment that Dr. Jaffe made,
12 correct?

13 A That's correct.

14 Q Could you just briefly describe that
15 matters?

16 A Yes. Professor Jaffe claims that the
17 record companies receive a greater promotional benefit
18 from radio play than do the music publishers. And as
19 I describe -- or I analyzed that position in my study
20 and have concluded that in fact there really is no
21 basis for that adjustment.

22 Q Let me ask you to turn to page 4 of your

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1 written testimony, Dr. Schink. And beginning on page
2 4, you have section 3 called the Broadcast Radio
3 Musical Works Benchmark, correct?

4 A That's correct.

5 Q Would you describe briefly what the
6 purpose of this section is?

7 A Well, the purpose of the section is, in
8 fact, to demonstrate that what I refer to as the
9 metric, the way the licensee is measured matters and
10 that the license fee that Professor Jaffe uses a
11 benchmark is stated in percentage terms and was
12 negotiated in that market in percentage terms, and
13 therefore it's appropriate to keep it in those terms
14 if you're going to use it as a benchmark.

15 And secondly, that the metric matters in
16 the sense that the results produced on the basis of
17 the percentage license fee differ from those produced
18 using the per performance fee substantially. There's
19 no stable relationship between the two.

20 Q All right. In the paragraphs 9 to 11 you
21 talk about the musical works license fees in the radio
22 broadcasting arena, correct?

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1 A That's correct.

2 Q And let me just ask you to briefly
3 explain. First of all, you talk about a blanket fee.
4 Dr. Jaffe in his analysis used blanket license fees,
5 correct?

6 A That's correct. He based his per
7 performance license fees solely on blanket license fee
8 results.

9 Q Okay. And those blanket license fees were
10 calculated pursuant to agreements that the PROs had
11 with the radio broadcasters, correct?

12 A Yes, they were. The PROs negotiated with
13 the broadcasters and negotiated percent of net revenue
14 type licenses. And certainly I'm not aware of any
15 licenses that are negotiated by them in other terms,
16 and certainly I've seen none in the year 2000, which
17 is the year that Dr. Jaffe does his analysis.

18 Q All right. Let me ask you to turn to your
19 first slide, and you show there, do you not, the
20 different blanket license fees charged by the PROs?

21 A Yes, I do. These are taken from the
22 actual agreements that were in place in the year 2000.

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1 The ASCAP fee is 1.615 percent. The BMI fee is 1.605
2 percent of net revenues.

3 I have estimated a percent of revenue fee
4 for SESAC based on their share of the catalogue of .1
5 percent.

6 The total of these three is 3.32 percent.
7 And that's what a radio station would pay of net
8 revenues under a blanket license.

9 Q Now, Professor Jaffe takes the blanket --
10 well, he takes the actual royalty fees paid by a
11 certain number of radio stations and converts those
12 into a per performance royalty rate, correct?

13 A That's correct.

14 Q Okay. And you believe that that's an
15 appropriate approach?

16 A It's inappropriate, yes.

17 Q Why is it inappropriate?

18 ARBITRATOR VON KANN: Can we just stop for
19 one second on that. Why did you have to estimate the
20 SESAC percentage? Is that information that there's no
21 way to find out exactly what the SESAC percentage
22 actually is?

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1 THE WITNESS: The SESAC licenses are not
2 specifically in percentage form. They have a
3 complicated schedule based on the maximum advertising
4 rate per hour and the size of the market. So in other
5 words, the more advertising revenues the station gets
6 the higher the rate they pay and the bigger the market
7 is in the higher the rate they pay. So they have a
8 multiple page schedule.

9 It functions something like a -- you know,
10 it implicitly works something like a percentage
11 license because bigger markets have more revenues.
12 And the higher you charge per advertising minute, the
13 more revenue you'll get. So it's like a percentage
14 revenue in terms of its effect, but it's actually a
15 lengthy schedule of annual based on your maximum
16 advertising rate and your size of your market.

17 So, this was estimated based on their
18 share of the catalogue. It's essentially they're
19 about three percent of the catalogue and in essence
20 I've assumed that their average rate is the same as
21 the average for ASCAP and BMI.

22 ARBITRATOR VON KANN: Okay. And secondly,

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1 and if you're going to get this later, fine, I
2 understand you're about to explain why you don't
3 believe it's appropriate to convert from this
4 percentage of revenue metric to a per performance
5 metric. Before we get to that, I want to try to
6 remember whether are these percentage figures that you
7 have started with the same percentage figures that Dr.
8 Jaffe has started with? My recollection is that it's
9 in the ballpark, but I can't recall it. Does he agree
10 that it is exactly 3.32 percent or has he got a
11 different starting number?

12 THE WITNESS: He never estimated a value
13 for SESAC. In his rebuttal I think he talks about
14 numbers for this -- for the webcaster market in the
15 range of 3½ percent and -- he doesn't present a
16 specific number. He does cite the ASCAP and BMI rates
17 I have here. He estimates -- he does include SESAC
18 license fees in his calculations, but he never
19 actually converts it to a percentage.

20 So, we agree in ASCAP and BMI, he never
21 estimated what implied percentage rate for SESAC.

22 ARBITRATOR GULIN: He looks at absolute

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1 numbers?

2 THE WITNESS: He looked at absolute
3 numbers paid including SESAC, he doesn't --

4 MR. RICH: Yes. I think inadvertently
5 that's a little misleading to suggest that we agree,
6 meaning Jaffe agrees on those percentages. He never
7 speaks in terms of the percentages.

8 ARBITRATOR VON KANN: He does it in terms
9 of total revenue as opposed as to these percentages or
10 license fees paid?

11 THE WITNESS: Well, he does cite the ASCAP
12 and BMI fees, at least -- I think somewhere in his
13 testimony as being these percentage. I think in the
14 footnote, at least. But he does work in his analysis
15 with actual fee data

16 ARBITRATOR VON KANN: Okay. Thank you.

17 BY MR. GARRETT:

18 Q Before we talk about why it was
19 inappropriate for him to convert percentage of revenue
20 fees into per performance fees, let me ask you about
21 another form of license that ASCAP and BMI offer.
22 That's the per program license.

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1 A That's correct.

2 Q All right. And you provide -- let me ask
3 you to go to the next slide.

4 And can you explain what per program
5 license fee is?

6 A The per program license fee is used for
7 radio stations that, in fact, play -- have some music
8 programming and some not music programming. In other
9 words, music programming is part of but not the
10 entirety of their broadcast product.

11 Q And generally it's a smaller portion of
12 their overall program offerings, correct?

13 A It's generally less than half, I think, as
14 I recall.

15 Q You have up on the slide there program
16 fees. Those are the per program fees charged by who?

17 A By ASCAP. I didn't note that these are
18 the -- the BMI fees are similar but these are
19 specifically the ASCAP fees for illustration.

20 Q Can you just describe what the fee is on
21 a per program basis?

22 A Yes, the fee applies only to -- and the

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1 estimated revenues that were generating during the
2 hours when music played. The fee of -- there's a fee
3 schedule of 4.22 percent for the first ten percent of
4 hours in which music played, weighted hours actually.
5 And then 2.135 percent thereafter, which is
6 substantially higher than a 1.615 percent charged by
7 ASCAP under the blanket rate.

8 Secondly, they have what they call
9 incidental music use fee, which covers the use of
10 music in the other parts of their broadcasting. And
11 that is a .24 percent of all net revenue, which is --
12 essentially it's on top of the two fee -- per program
13 fees.

14 Q And you discuss on page 5 of your written
15 testimony in footnote 2 the per program license fees,
16 correct?

17 A That's correct.

18 Q And you talk about the relevance for the
19 webcasting arena here, correct?

20 A That's correct.

21 Q Could you just briefly describe what point
22 you were making there?

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1 A Well, a number of the webcasters are like
2 the radio stations that, in fact, would us the per
3 program fee in the sense that the DMCA streaming is a
4 part of what they offer, but they offer other things
5 to attract visitors, just as these radio stations
6 offer music and other things to attract listeners.

7 And for webcasters of that sort I think
8 the appropriate -- it would be more appropriate to
9 start with the per program license fees in the
10 broadcast radio arena and then -- and do the
11 conversion -- or if you were going to do a benchmark
12 based on radio, you would for those type of
13 webcasters, you should start with the per program
14 rates.

15 Q Okay.

16 ARBITRATOR VON KANN: Why is that?

17 THE WITNESS: Well, Professor Jaffe says
18 we should look to radio broadcasting arena to
19 determine a benchmark and then move it over
20 appropriately to the webcasting arena.

21 Now, there are some webcasters that are
22 like sort of the all music radios, the pure DMCA

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1 streamers for which the blanket license approach would
2 be appropriate. There also are a substantial number
3 of webcasters who are more like the stations who would
4 use the per program license, because only a part of
5 their revenues are attributable to music programming.
6 These webcasters only a part of their revenue stream
7 is due to DMCA streaming.

8 In Professor Jaffe's benchmark -- under
9 Professor Jaffe's benchmark the percentage applied to
10 the revenues that were attributable to music would be
11 higher for those who only use music part of the time.

12 So if you're going to try to do
13 comparables in both markets, you'd want to have a
14 blanket rate and a per program rate; apply the blanket
15 rate to the pure streamers and apply the per program
16 rate to those who have a mixed revenue stream.

17 CHAIRMAN VAN LOON: Dr. Schink, your
18 footnote 2 says that these apply where a substantial
19 part of the net advertising revenue is unrelated to
20 music play. And is there a bright line test for
21 substantial part, a number; 50 percent or anything
22 like that, or how do they determine?

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1 THE WITNESS: Any radio station can elect
2 to either take a per program or blanket license and
3 they'll take the one that, obviously, will allow them
4 to pay lesser revenues. The break even point -- it's
5 something over more -- something over 50 percent music
6 broadcasting I think you'd switch over. I haven't done
7 the calculation precisely, but at some point it would
8 become cheaper to go to a blanket license and radio
9 stations would do so.

10 So, I think they would calculate what they
11 would pay under both licenses, and pick the one under
12 which they'd pay less, which is fairly logical.

13 BY MR. GARRETT:

14 Q Dr. Schink, let me ask you to move to the
15 next slide. And just so we're also clear on the
16 record here, Dr. Schink, you're not urging the panel
17 here to use as a benchmark anything related to radio
18 payments, are you?

19 A No, I'm not advocating using a radio
20 benchmark. I think there are significant differences
21 between the markets and the use of a radio benchmark
22 is troublesome because of the differences between the

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1 webcasting and broadcasting arena. And I think the
2 differences are such that it's not the way to go.

3 On the other hand, if you are going -- you
4 know, if they were to choose to go that way, I think
5 there are many problems with Professor Jaffe's
6 analysis that have to be addressed.

7 Q So you're here to make the adjustments
8 that the panel requested that we make?

9 A That's correct.

10 Q All right. You were going to talk a few
11 minutes ago about why it was inappropriate for Dr.
12 Jaffe to convert the percentage revenue fees into per
13 performance fees. Could you just briefly describe
14 your reasons for that conclusion?

15 A Yes. I think maybe the most important one
16 is when you're going to use a benchmark, you should
17 use the benchmark as it actually exists.

18 In the radio broadcast market the license
19 fee arrangements that are negotiated between the
20 performing rights organizations -- the performance
21 rights organizations, the ASCAPs, BMI, particularly
22 and the broadcasters are negotiated in percentage of

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1 net revenue terms.

2 And so Professor Jaffe's benchmark, the
3 benchmark that's -- the benchmark market uses
4 percentage of net revenue type licenses. They
5 certainly do not now use, and I'm not aware of them
6 ever having used, a per performance type license fee.
7 In fact, I've been told by people who have worked and
8 consulted for ASCAP and BMI that they're opposed to
9 it. Are strongly opposed to it.

10 So if you're going to use the benchmark,
11 you should use the benchmark as the parties within the
12 market have negotiated, not convert it to something of
13 your own creation which you purport to be the same.

14 The second problem with this or second
15 issue is that they aren't the same. The percentage of
16 net revenue license approach and Professor Jaffe'
17 proposed per performance rates do not produce the same
18 results.

19 Q Let me ask you to turn to your appendix A.
20 And you describe in greater detail in appendix A the
21 point that you were just making, correct, Dr. Schink?

22 A That's correct. It is also described, I

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1 think in summary form, in paragraph 15 of the text.

2 Q Well, just very briefly I'm going to ask
3 you to explain generally what you have in appendix A,
4 but before I do the data that you have here in
5 appendix A or the data that you rely upon in appendix
6 A was data that was contained originally in Dr.
7 Jaffe's direct testimony in this case?

8 A These are the data that Dr. Jaffe
9 collected from approximately 900 non-randomly selected
10 radio stations who were operating under blanket
11 licenses that he used to calculate his revenue per
12 listener hour and listener song results. And these
13 were the data that in fact had been used in his direct
14 testimony.

15 Q All right. And you're aware, are you not,
16 that Dr. Jaffe has made changes in his rebuttal
17 testimony to certain of that data?

18 A Yes, he's made revisions and fixed errors,
19 I guess, and added some additional data.

20 Q All right. And have you had the
21 opportunity to analyze the new data?

22 A Yes, I have.

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1 Q Does that new data in any way effect the
2 conclusions that you reach here in appendix A?

3 A No, the conclusions that the two methods,
4 that the percentage of net revenue method and the per
5 performance methods produce substantially different
6 results holds up fully in using the new data.

7 Q Okay. But I take it that when you use the
8 new data there are some, at least, minor changes in
9 the specific numbers contained here in appendix A,
10 correct?

11 A There are.

12 Q And those changes in the numbers do not
13 effect your overall conclusions?

14 A That's correct.

15 Q Could you just briefly describe the
16 information that you have in appendix A?

17 A Well, basically what -- I think if we
18 could turn or take a look at tables A2 and A3 in the
19 appendix, which basically show the range of result
20 that you obtain for license fees, for the actual
21 license fees paid relative to the averages within each
22 group. And what I show in table A2, this is on the

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1 per listener hour; I show the average fee for all
2 formats and then I calculate the average fee paid for
3 the different formats. And then just show the range
4 from low to high of actual fees paid by the radio
5 stations contained in this group based on Dr. Jaffe
6 data.

7 And for all of them the range is described
8 on page 4. It goes from .03 cents per listener hour
9 on the bottom to almost a penny on the top. And his
10 average is .22 cents per listener hour. So you get a
11 substantial range of results. And the same holds up
12 if you look at A3 with the calculations done on a per
13 listener song format.

14 Now, the other thing that I've done in her
15 is to look at -- if you look at -- go back to A2. If
16 you look at the average values across formats there,
17 they're not -- you know, they vary up and down. And
18 that led me to ask the question well are the average
19 license fees paid per listener hour the same or are
20 they different. And table A4 shows that for most of
21 the cases, for 8 of the 10 cases in listener hour and
22 7 of the 10 cases in per listener song the average is

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1 -- the average fee per listener hour in a given format
2 is statistically different from that in all the other
3 formats. So there's no consistent average across
4 formats.

5 And in table A5 and A6 what I look at is
6 the difference between --

7 CHAIRMAN VAN LOON: Dr. Schink?

8 THE WITNESS: Yes. I'm sorry.

9 CHAIRMAN VAN LOON: Well, I'm sorry.
10 Before you go on to 5, you just said that the average
11 varies sufficiently so that there's no consistent
12 number. If you look at the chart at A2 I suppose
13 compared to -- if you draw a line connecting the
14 averages, it's certainly a straighter line, less
15 variation than looking at the others.

16 How much variation would be allowable on
17 that average line that would enable you to say that is
18 steady and varying? I mean, what's your test of how
19 far above and below?

20 THE WITNESS: The test is based on the
21 variability about that mean you see. In other words,
22 how much variance is there around that mean.

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1 So in essence the test that is shown on A4
2 was what's called a T-test. And what that does is it
3 compares the difference -- looks at the difference in
4 the means relative to the variability of the data
5 around that mean. So the greater variability there is
6 in the data, in essence, the farther apart the means
7 have to be to be considered statistically different.
8 So you got a lot of variance in the data, the means
9 have to be further apart for you to consider them to
10 be statistically different.

11 CHAIRMAN VAN LOON: I understand that.
12 But what I'm trying to ask is what the number is?

13 ARBITRATOR VON KANN: How much is too
14 much?

15 CHAIRMAN VAN LOON: Yes. I mean, if the
16 maximum variation there was plus or minus one percent,
17 would that be consistent? But if it's plus or minus
18 11 percent, then it's not? I mean --

19 THE WITNESS: Well, I can do that better.
20 It's actually kind of hard to -- I could do the
21 calculation, but I haven't done it. It's not
22 something I can do easily as I sit here.

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1 But we're talking differences of, oh,
2 let's see. You have differences here as big as almost
3 .1 cent in a variation you see. So, and then some of
4 these differences can be fairly big.

5 MR. RICH: Could the witness point out for
6 the record where that variation of .1 cent appears on
7 A4?

8 THE WITNESS: Take a look at Spanish, it's
9 .15 versus .22. I guess it's just .07. I rounded up
10 generously. I mean that difference is statistically
11 significant different.

12 ARBITRATOR VON KANN: Just to follow up,
13 I think I may be a little confused or not fully
14 understanding the column marked significance of mean
15 in equality. I thought what that was saying, but I
16 think now I'm wrong, is that in each of these
17 different categories there's that much variation of
18 the mean. But I think as I look it a bit more, that's
19 not correct.

20 THE WITNESS: No. That is the
21 significance of the test. The lower that number, the
22 greater confidence you have that the two means are

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1 different. And usually the cut off I've used you have
2 to have, you know, 5 percent or lower probability.

3 It's a probability that in fact of
4 incorrectly rejecting the hypothesis that the two
5 means are the same. So there's only a 5 percent
6 chance. In the real world the means could be the same
7 given the data that I have.

8 ARBITRATOR VON KANN: What are the two
9 means that you're talking about?

10 THE WITNESS: In table 4 it's the mean for
11 a given format versus a means for all other formats.

12 ARBITRATOR VON KANN: Ah. So it's the
13 mean of all versus the mean of a specific category?

14 THE WITNESS: All other.

15 ARBITRATOR VON KANN: Or all other?

16 THE WITNESS: It's Spanish versus
17 everything but Spanish. So the data for the one
18 you're testing isn't in the other group.

19 CHAIRMAN VAN LOON: You said just a minute
20 ago that you look at sort of 5 percent as the ceiling.
21 You want to be 5 percent or less.

22 If you look at the last column on the per

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1 listener song, there you've got all one percents on
2 nonsignificant.

3 THE WITNESS: One percent says there's
4 only a one percent chance that I could incorrectly
5 reject that. One percent is even stronger test. The
6 lower the number, the more confidence I have that the
7 two means are in fact different.

8 CHAIRMAN VAN LOON: Oh, oh. So it's a
9 double negative essentially?

10 THE WITNESS: Yes, that's a double
11 negative.

12 CHAIRMAN VAN LOON: So put another way, a
13 one percent here means you're sort of 99 percent
14 confident that they're --

15 THE WITNESS: They're different.

16 CHAIRMAN VAN LOON: That they're
17 different.

18 THE WITNESS: And a 5 percent says I'm 95
19 percent sure they're -- that they're different.

20 ARBITRATOR GULIN: I guess I'm missing
21 something maybe. Why is it so important that the mean
22 of a particular format be exactly the same as the mean

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1 for all formats? It would be almost incredible to
2 think that the means would not vary between formats.
3 The question is what is the mean for all the formats,
4 and is that a fairly representative mean? I guess
5 that goes to the question that the Chair was asking.

6 THE WITNESS: Well, the mean for the all
7 others is roughly equal to the overall mean. If you
8 exclude one format, it doesn't change it
9 significantly.

10 What these tests show is that in fact, you
11 know, on average the means are not the same across
12 performance. The reason for doing this, the purpose
13 of this, Professor Jaffe says I can compute one number
14 and it's going to be a reasonable fit for everything.
15 And what I've tried to show here is it's not even a
16 reasonable fit across different formats. That, in
17 fact, the rate that's actually -- the average rate
18 that's actually paid in the radio broadcasting arena
19 where the rates are actually calculated using
20 percentages, vary significantly across formats. So
21 it's not even a good approximation on average across
22 the different formats.

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1 Now I did this arguing because there are
2 going to be differences in format also in webcasting.
3 And if, you know, the argument being if you have a
4 different mean, say, for one type of format in radio,
5 you'd have to try to define a comparable format in
6 webcasting. And this gets hopelessly complicated by
7 doing that.

8 So he essentially argues that one size
9 fits all. And I'm arguing that that his own data
10 suggests that one size doesn't in fact fit all.

11 ARBITRATOR VON KANN: Is another way of
12 saying that that his per -- I don't what he calls it.
13 I forgot it.

14 THE WITNESS: Per listener hour.

15 ARBITRATOR VON KANN: Per listener hour
16 metric does not actually tell yo accurately what most
17 Spanish music stations play, because they're off the
18 mean this way and it doesn't exactly tell you
19 accurately what most -- I don't know, some other,
20 adult--

21 THE WITNESS: Yes.

22 ARBITRATOR VON KANN: Because they're off

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1 the mean that way. And so if you use this single
2 formula, that doesn't actually correspond with the
3 amounts of royalties really paid by these different
4 categories of stations?

5 THE WITNESS: That's correct. So one size
6 doesn't fit all; that's the point.

7 ARBITRATOR VON KANN: Does the use of his
8 single metric tell you overall? If you took all the
9 royalties from all the radio stations that he analyzed
10 and then applied that per listener hour metric, would
11 that be an accurate way to arrive at the royalty that
12 these stations paid in the aggregate?

13 THE WITNESS: The average revenue
14 generated overall usually averages total revenue. But
15 the problem is that what individual stations or groups
16 of stations pay can be widely different than that.
17 And that within -- given that Professor Jaffe has
18 stated -- I'm going to use the benchmark from radio,
19 which is percentages. And under that percentage
20 format the different formats, the different types of
21 stations pay widely different fees per listener hour.
22 He's no longer using his benchmark. It's not -- I

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1 mean, he's using -- you know, he's trying to quote
2 something he concocted whole cloth as if it were a
3 radio benchmark, and it's not.

4 ARBITRATOR VON KANN: Okay.

5 THE WITNESS: Without getting into it, the
6 similar thing applies. There's a substantial
7 difference based on market size. The average fee per
8 listener hour also is higher there. The whole message
9 of this is that there's no stability in the
10 relationship between the -- between the fee that would
11 be calculated to determine, based on his percentage of
12 net revenue benchmark and what his formula would
13 apply.

14 The relationship is not stable or
15 consistent or anything else, and I think this -- the
16 disparity I think was -- without getting into
17 specifics -- was demonstrated in Professor Jaffe's
18 cross when, in fact, his formula was applied to
19 specific radio stations, and, in fact, the differences
20 between what the formula said the stations should pay
21 and what they actually did pay is wildly different.

22 ARBITRATOR VON KANN: Wildly on what order

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1 of magnitude; do you recall?

2 THE WITNESS: I don't recall exactly, and
3 I say the number I think we have to go into closed
4 session. I do not recall what the number was.

5 ARBITRATOR VON KANN: I think what was I
6 confused about -- and I'm now I think
7 semi-unconfused -- is that you're not saying that he's
8 1 percent off from the Spanish stations or 5 percent
9 off.

10 THE WITNESS: No.

11 ARBITRATOR VON KANN: That's a statistical
12 measurement. But are they significantly larger? I
13 guess for a 1 percent variation I don't know that I'd
14 crucify him; 5 percent maybe. I mean, are we talking
15 orders of 10 or 20 or 40 or something percent?

16 THE WITNESS: The orders of differences
17 are illustrated in Tables A2 and A3. I mean, the
18 range of results you get for an individual -- his
19 average for all stations would say that everybody pays
20 .22 cents per listener hour, but you're going to find
21 stations that pay a penny per listener hour. That's
22 an order of almost five.

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1 ARBITRATOR VON KANN: I see. Okay.

2 CHAIRMAN VAN LOON: Does this sound right,
3 Dr. Schink? Looking at Table A4, second column,
4 average for the format, at the top is 22135.

5 THE WITNESS: That's correct.

6 CHAIRMAN VAN LOON: So just for
7 statistical fun, I just knocked off the highest number
8 and the lowest number in the column of numbers right
9 below that, which are outliers. So the second highest
10 number is modern rock 25615.

11 THE WITNESS: That's correct.

12 CHAIRMAN VAN LOON: And the lowest is
13 rhythm and blues 17828.

14 ARBITRATOR VON KANN: What about the one
15 below that?

16 CHAIRMAN VAN LOON: Well, I knocked off
17 the outliers.

18 THE WITNESS: It's essentially .18 to .26.

19 CHAIRMAN VAN LOON: What I've got is
20 15 percent above and 19 percent below.

21 THE WITNESS: These ought to be pretty
22 average.

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1 CHAIRMAN VAN LOON: You can sort of just
2 feel --

3 THE WITNESS: Right, the feel.

4 CHAIRMAN VAN LOON: -- there's sort of a
5 fifth up or down.

6 THE WITNESS: Right. That's a correct
7 translation.

8 BY MR. GARRETT:

9 Q Dr. Schink, you started discussing your
10 concern in this area here by talking about the actual
11 metric that has been agreed to in the marketplace,
12 correct?

13 A Correct.

14 Q And actual metric is a percentage of
15 revenue, correct?

16 A Correct.

17 Q And the what you've moved into here is the
18 variation in the particular per-performance fees,
19 correct?

20 A Correct.

21 Q Given the variation that you described, if
22 you were the owner of a radio station, would

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1 Dr. Jaffe's average fee have any economic meaning to
2 you?

3 A No, it would not, because I would know I
4 was going to pay a fee that was based on a percentage
5 of the revenues I actually collected. And I would
6 have, essentially -- I would probably have no feel
7 whatsoever for what it meant on a per-performance
8 basis because that's not how I pay them.

9 Q And no radio stations have agreed to a
10 per-performance type of a metric, have they?

11 A Not that I'm aware of, certainly.

12 ARBITRATOR VON KANN: Can you help me
13 understand why there is this variation? Is it
14 because -- for instance, we heard some testimony I
15 think at one point that Spanish music stations play on
16 average longer records, so that there are fewer sound
17 recordings played on a Spanish station than on a pop
18 40 station.

19 Is it the variation in the number of
20 songs? What accounts for this variation that you've
21 just described?

22 THE WITNESS: No, it has nothing to do

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1 with how many songs are played per hour. It has to do
2 with what value advertisers assign to the listener
3 audience that that radio station is able to attract.

4 And so there's two things that advertisers
5 take into account-- how big is your audience and what
6 are their demographics. If there demographics are
7 good to sell things through, and you've got a lot of
8 them, they'll pay you a higher rate per minute of
9 advertising.

10 So, basically, the amount of money you
11 get -- and the net revenue you get -- is really a
12 function of how big the audience is you can attract,
13 and whether they have good demographics to market to,
14 whether they have money to spend, and whether they're
15 of an age group that tends to spend. I mean, they
16 love males 20 to 35 because they buy big, expensive
17 toys.

18 ARBITRATOR VON KANN: Is this the point?
19 There isn't a consistent relationship between revenues
20 of different stations and numbers of songs played?

21 THE WITNESS: As far as I know, there's
22 absolutely no relationship between revenue and number

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1 of songs played, not a consistent one anyway. There's
2 no reason for it to be. The revenues you get are a
3 function of the size of the audience you get and
4 whether or not that the audience that you've
5 attracted -- however you've done it, playing a lot or
6 a few songs an hour, or having good jockeys, whatever
7 it is-- what the value of that audience is to the
8 advertisers.

9 MR. RICH: May I get that answer read
10 back, please? I missed a little bit of it.

11 (Whereupon, the foregoing matter went off
12 the record at 9:56 a.m. and went back on
13 the record at 9:56 a.m.)

14 ARBITRATOR VON KANN: The problem -- if I
15 get it then -- is not that Jaffe made mistakes in his
16 arithmetic or that he made mathematical -- the problem
17 is that a station that has a huge listenership and is
18 able to track a lot of advertising revenue may
19 actually play very few songs. And another station may
20 be playing songs like crazy and have low revenue.

21 THE WITNESS: That's correct.

22 ARBITRATOR VON KANN: And so, in essence,

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1 there isn't any consistent relationship between the
2 revenue of a station and how much it's using sound
3 recordings?

4 THE WITNESS: Correct.

5 ARBITRATOR GULIN: Wouldn't one expect
6 that formats that attract a lot of listeners would
7 have a greater value than formats that don't attract
8 a lot of listeners? And, therefore, when that's
9 averaged out, that's all subsumed -- that all becomes
10 part of the average, and, therefore, has no meaning,
11 unless I'm not understanding this correctly.

12 THE WITNESS: Clearly, a station that
13 attracted more listeners would be expected to have
14 more revenue. But if, in fact, it all sort of worked
15 out, then what you ought to see in the data is a
16 fairly narrow range of values of dollars per listener
17 hour. If one listener is worth the same as any other
18 listener, the revenue per listener hour across
19 stations should be virtually the same. And I think
20 the data that I -- Professor Jaffe's own data says
21 that's not true.

22 ARBITRATOR GULIN: Okay. And that may be

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1 as a result of the demographics, perhaps, that maybe
2 one format is appealing to a different demographics.

3 THE WITNESS: Or even within a format
4 somebody is doing better than somebody else,
5 attracting the kind of audience people want. Format's
6 only part of it. I mean, if format was the only thing
7 that mattered, we shouldn't see any variance in the
8 results within a format. But as you can see from
9 my -- from just looking at Professor Jaffe's data,
10 there's a wide variance in revenue per listener hour,
11 even within formats. So there's numerous factors that
12 affect it. And you can't control for that variance or
13 variability by dividing by listener hours. It just
14 doesn't capture what you need to capture.

15 ARBITRATOR GULIN: Thank you.

16 BY MR. GARRETT:

17 Q Is it fair to say, Dr. Schink, that there
18 is a relationship between revenues and the nature of
19 the programming that a broadcaster provides?

20 A Yes.

21 Q And what would include the nature of the
22 sound recordings that they provide?

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1 A Yes.

2 Q Let me ask you to turn to Section 4 of
3 your report which begins on page 10. Do you have that
4 there?

5 A Yes, I do.

6 Q Could you briefly describe the purpose of
7 that section?

8 A The purpose of this section is to examine
9 the relationship between the appropriate musical works
10 license fee and sound recording license fees in the
11 webcasting framework. And the study first looks at
12 the economic theory and logic underpinning that would
13 lead you to assess what the -- help you assess what
14 the relative value should be, and then proceeds to,
15 based on that theory and logic, to develop a
16 methodology that incorporates it and to produce
17 estimates of the relative license fees for sound
18 recordings and musical works.

19 Q Let me ask you just to turn to the next
20 slide.

21 Now, Professor Jaffe argues that the
22 webcasters' compensation of the owners of musical

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1 works should be equal to their -- let me strike that.

2 You discuss here in this section here the
3 different values of musical works and sound
4 recordings; is that correct?

5 A Correct.

6 Q And you disagree with Dr. Jaffe's
7 conclusions concerning the relative values of sound
8 recordings and musical works, correct?

9 A Correct.

10 Q Could you just briefly describe why it is
11 that you disagree with Dr. Jaffe's position?

12 A Professor Jaffe bases his approach on some
13 economic arguments which I believe are not sound. In
14 the first instance -- he had, essentially, two
15 different arguments. In the first -- which support
16 the same conclusion or support his -- or he purports
17 support his conclusions -- first, Professor Jaffe
18 ignores the cost of producing sound recordings in
19 determining the relative value of the contributions of
20 the record companies and the music publishers to
21 producing and delivering a sound recording. He does
22 this because he argues these costs are sunk; that

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1 they've already been incurred and are irrelevant to
2 pricing in the market that he's concerned with, which
3 is delivery of sound recording performances to
4 webcasters.

5 In fact, this result is arrived at by
6 taking a static look at the market, which I think is
7 inappropriate. If you take a dynamic forward-looking
8 look at the market or valuation of the market, these
9 costs are not sunk. In fact, it's appropriate to look
10 at the cost of producing the sound recording as well
11 as the cost of delivering it in trying to assess what
12 the appropriate relative fees should be.

13 Q Could you just briefly describe what you
14 mean by static of market and a dynamic market?

15 A Well, a static market, basically, only
16 looks at sort of history as it has been done. It
17 might be better done by an analogy and an example. If
18 you took -- I'll use a hypothetical following
19 Professor Jaffe, a different hypothetical.

20 If you had a baker, and this baker
21 had -- it was getting towards the end of the day, and
22 this baker had one loaf of bread left on his shelf.

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1 And somebody -- a person comes in, and he's about to
2 close, there's nobody in the street, there's no other
3 customer going to come in. So his choice at that
4 instance is to sell that one loaf of bread to the
5 baker -- or to the customer for whatever he can get or
6 not. So he'd normally sell it for 50 cents. The
7 customer says, I've got no money; I'll give you a
8 nickel. Well, assuming the guy was irrational in that
9 circumstance, he'd look at the one loaf of bread and
10 say, well, it's better than getting nothing for it.
11 Here's your loaf of bread; I'll take my nickel.

12 Now, this didn't cover the production cost
13 of the bread or anything else, but his alternative
14 that day, at that static moment, was to take a nickel
15 or take nothing. But that isn't going to affect how
16 much bread he's going to produce because if he's
17 rational tomorrow, he'll produce one less loaf of
18 bread.

19 So Professor Jaffe says, I only want to
20 look at what's on the shelf of the baker today; I
21 don't want to look at what he might do tomorrow. And
22 I think that's the inappropriate way -- this panel is

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1 setting rates to carry forward as the additional
2 loaves of bread are produced, as the additional sound
3 recordings are made. I think you have to -- it's
4 appropriate to look at it, given what's being done
5 here, in a dynamic forward-looking matter as opposed
6 to a static matter.

7 Q You also discuss in this section a second
8 reason why you disagree with Dr. Jaffe's approach.
9 Can you explain that?

10 A Yeah. Professor Jaffe comes up with a
11 very peculiar sort of sequential way of looking at
12 joint outputs of production. He says, well, you have
13 sort of primary and secondary products. And he says,
14 the primary product of this process is producing the
15 sound recordings, and the secondary product is, in
16 fact, delivering the sound recording to the
17 webcasters. And in that context he says, the cost of
18 producing the sound recording has been sort of covered
19 elsewhere, and we don't have to worry about it in this
20 context.

21 In fact, economic theory -- this is not
22 the way economic theory deals with this. Intermediate

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1 microeconomics at the undergraduate level says you
2 have a joint output problem, joint output issue. And
3 what you should look at is you look at all the outputs
4 you look at all the revenue generated to that, and you
5 base your production decisions based not on the
6 revenue of one or two or three of the outputs, but all
7 of the outputs. And the idea of primary or secondary
8 never enters into it whatsoever. And so all the
9 revenue matters -- revenue is revenue, essentially.

10 What Professor Jaffe is doing is making
11 what is -- occurs a lot in a regular framework, the
12 so-called free-rider argument, because this is already
13 paid for by somebody else; I don't have to worry
14 about -- you don't have to worry about me contributing
15 to that or paying for it.

16 So I think it's a very -- it's often made
17 by people who want low-rates argument, but I think
18 it's been seen as inappropriate in every regulatory
19 environment I've ever looked at, and I think it's
20 inappropriate here.

21 Q Your next slide here --

22 ARBITRATOR VON KANN: On that section,

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1 Mr. Garrett --

2 MR. GARRETT: Section 4.

3 ARBITRATOR VON KANN: Just a comment on
4 the incremental cost, the sum-cost issue.

5 MR. GARRETT: Oh, sure. Go ahead.

6 ARBITRATOR VON KANN: I think this issue
7 is one of the more difficult ones to get handled on,
8 and we have a different view of it from Professor
9 Jaffe and Professor Wildman and from you, and I'm
10 still trying to understand it. And we've got
11 different analogies.

12 Does it make any difference in analyzing
13 this that this is not a situation where in order to
14 supply a new market -- whether you call it a secondary
15 market, or an additional market, or whatever it
16 is -- we don't have to produce more CDs. The number
17 of CDs is sort of fix. That's what we need to supply
18 the stores, and the Amazons, and so on. This
19 additional market doesn't require additional physical
20 product. They get one record, and they can use it, or
21 they can even get it now I guess digitally.

22 So I don't think there's much evidence in

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1 the record -- I might be wrong about this -- that
2 because webcasters are now out there streaming the
3 music, all the record companies are going to have to
4 up their production of CDs by 10 percent, or
5 20 percent, or something. I don't think there's any
6 real evidence that supplying that, getting the sound
7 recordings out to the webcasters is not going to
8 require significant additional product. It's a new
9 use; no question about that, and one to which revenue
10 can be attached. And we're right here wrestling with
11 how you do that.

12 But is there any significance, from your
13 point of view, in saying this is a free ride or
14 argument, it's a stable market analysis rather? Is
15 there any significance to the fact that this new use
16 does not impose significant additional production
17 costs on the record companies?

18 THE WITNESS: Well, it's certainly
19 inappropriate from an economic logic and theory point
20 of view. It's the -- my argument is he argues that
21 this webcasting play is sequential to the main
22 business, and, therefore, isn't going to affect the

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1 outcome of the main business. And the economic theory
2 simply reaches an opposite conclusion. All revenues
3 matter equally; a dollar is a dollar. And the more
4 revenue you get in total as a result of producing
5 sound recordings, from selling CDs, or getting money
6 from downloads, or getting money from webcasters,
7 increases the revenue, and increases the production.

8 If my baker would have made -- if the guy
9 who came in paid him what it would have cost him to
10 produce it, the 50 cents, he would have made that loaf
11 the second day also.

12 In this context, if you look at all the
13 recordings that are made to date, Professor Jaffe's
14 right. That's why it's static. He's only -- but he
15 says, okay, going forward is this going to matter?
16 And my argument is that the more revenue you have, the
17 more sound recordings will be made, because at the
18 margin -- the decision of whether we record this group
19 or not is made at the margin. And incremental
20 revenues, some other sources might push groups that
21 are not now recorded because the total revenue that
22 they can see -- that the record companies can see

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1 being generated by recording that, aren't sufficient
2 to do the recording.

3 You add any extra revenue stream, it's
4 likely, in an going-forward basis, that additional
5 groups, a greater number of groups, groups that
6 otherwise would not have been recorded, will be
7 recorded.

8 ARBITRATOR VON KANN: Are you suggesting
9 that additional revenues coming from webcasting, these
10 royalties, the result will be more revenue flowing
11 into the record companies, and that will prompt them
12 to make more sound recordings than they otherwise
13 would make?

14 THE WITNESS: On a going-forward basis,
15 yes. Because the total revenue that they can expect
16 to earn from a sound recording has gone up by the
17 amount they can get from the webcaster. So the margin
18 of revenue they can get by making a sound recording
19 has gone up by the amount that they can get from the
20 webcasters. And the higher the margin of revenue you
21 can get from making a sound recording, the more sound
22 recordings you will make.

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1 ARBITRATOR VON KANN: Why wouldn't the
2 record companies say, "This is great; we just got in
3 an extra \$300 million or something here from the same
4 quantity of product that we produced. And guess what?
5 We're going to have a whopping big dividend for our
6 shareholders. We don't have to record any more bands;
7 we've got just the right number. No more production
8 costs, no more dealing with those damn artists,
9 advances and everything else. Keep the exact same
10 stable, but guess what? It's now generating a lot
11 more money."? Why wouldn't it just up their profits?

12 THE WITNESS: Well, because not reacting
13 to increased marginal revenue would not allow them to
14 maximize their profits. One of the rules of economics
15 is, if you increase marginal revenue, is profit
16 maximizing to produce more output? And I assume
17 they're going to try to maximize profits.

18 ARBITRATOR VON KANN: Is that, in your
19 view, the principal argument against Professor Jaffe
20 on this point, that it isn't -- you can't just say
21 these are sunk costs because of the given number of
22 sound recordings that have been made? Rather, he's

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1 neglected the opportunity for additional sound
2 recordings to be stimulated by this additional
3 revenue?

4 THE WITNESS: In the future. If you take
5 a look at this in a dynamic, rather than a static,
6 sense, you then -- you have to recognize that, in
7 fact, it's likely that more recordings will be
8 produced as a result of having this incremental
9 revenue stream from webcasters.

10 If you look at this in a dynamic context,
11 you, in fact, will have to recognize -- and Professor
12 Jaffe would have to recognize as an economist -- that
13 more revenue on a going-forward basis implies that a
14 profit maximizer would produce more recordings, and,
15 therefore, that's what one would expect to happen.

16 ARBITRATOR VON KANN: Just one more.
17 Putting that argument aside, why can't one just say
18 that if the record companies went into these
19 negotiations with webcasters in an effort to set the
20 royalty, they would say, "Look, guys, we have all
21 these production costs, and we've got to set a royalty
22 that bears some of that." And a webcaster would say,

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1 "Oh, wait a minute, that's already sunk. We're not
2 going to pay any of that." And the record company
3 would say, "Hey, it ain't written in the Ten
4 Commandments that you can't be charged for some of our
5 costs. Sure, we've already incurred it, but you
6 should pay some of it. And by the way, you really
7 want these records, don't you?"

8 Why is there a sort of impenetrable wall
9 that the record companies cannot try to pass on some
10 of these production costs in the negotiation simply
11 because they're paid. Yeah, they're paid, but we'd
12 like to recover some of it from you. That's the piece
13 that I haven't ever quite understood. Putting aside
14 this potential for more records, why is it sort of
15 written that one can never seek to recover some costs
16 from a new customer?

17 THE WITNESS: Well, it's not written that
18 you can't, but usually a contract is written -- a
19 contract is written to apply on a going-forward in a
20 dynamic sense. So you write the contract to apply for
21 a year, two years, five years, whatever the period is;
22 and you write it so it makes sense on a going-forward

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1 basis.

2 So you go into that -- the parties go into
3 it. And in that context, both parties realize that
4 the costs that are going to be incurred over the life
5 of the contract aren't sunk; they're going to be
6 incurred on an ongoing basis. And the parties
7 generally don't talk -- well, they can talk
8 cost -- what goes on in these negotiations is all over
9 the map -- but, basically, the parties' positions in
10 negotiations are based on what costs they expect to
11 incur on an ongoing basis for producing whatever
12 product is being delivered.

13 So the negotiation would reflect on
14 whether they were discussed directly or not because
15 the seller would know what its costs were going to be,
16 and would, in fact, be basing its negotiation position
17 on a recognition that it was going to incur these
18 costs on an ongoing basis, and that would affect its
19 negotiating posture. I think the record companies and
20 the webcasters, at least in 20 cases, have struck
21 agreements.

22 ARBITRATOR VON KANN: Thank you.

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1 ARBITRATOR GULIN: If I recall Professor
2 Jaffe's testimony a few days ago, I don't think he
3 would disagree with you. I think he, in fact,
4 explicitly agreed that the time will come -- I think
5 he used the terms -- when the market is established,
6 that the record companies will certainly take into
7 consideration this new revenue stream. And at that
8 point, they'll take more risks, they'll make more
9 records. That will be taken into consideration.
10 They'll have more costs.

11 The question is, when is that market
12 established so that that occurs? You talk about going
13 forward as if that time has already arrived. And I
14 think the difference between you and Dr. Jaffe is, he
15 believes that that time hasn't arrived yet; that the
16 market hasn't been established, the rate hasn't been
17 set. How do you respond to that?

18 THE WITNESS: I respond to it by saying
19 that you're setting rates here that are -- that will
20 apply for, what, two years, essentially? I don't know
21 the exact terms. But whatever the deliberations here
22 are, we'll have -- will not be ignored on a

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1 going-forward basis, certainly. And I think what
2 you're trying to establish is a sensible benchmark
3 framework. The mechanical rates framework was
4 persistent since the early part of the century. So
5 what you do here is certainly not irrelevant to what
6 will be -- will occur in the ongoing market.

7 My argument to that is that there's no
8 reason to set rates based on the wrong premise today
9 simply because the revenues that you're going to get
10 from the webcasting market in the near future are
11 relatively small. That's essentially what he's
12 saying. "Well, it doesn't matter if you get it
13 right." At least I read it -- my reading of that. It
14 doesn't matter if you get it right or not because it's
15 too small to matter. I don't -- I think that's not an
16 appropriate way to look at how this panel should, in
17 fact, be evaluating how rates are to be set.

18 MR. GARRETT: Mr. Chairman, is it possible
19 just to have a two-minute break?

20 CHAIRMAN VAN LOON: Absolutely. Why don't
21 we make it a 10-minute break? Come back at 10:30.

22 (Whereupon, the foregoing matter went off

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1 the record at 10:20 a.m. and went back on
2 the record at 10:34 a.m.)

3 BY MR. GARRETT:

4 Q Dr. Schink, you used a couple of different
5 methods to measure the relative values of the
6 contributions that record companies and music
7 publishers make to sound recordings, correct?

8 A That's correct.

9 Q If you could just describe those methods
10 briefly.

11 A I put up a slide. It's page 7. There's
12 two ways of looking at this. One is to measure the
13 relative contributions of the record companies, the
14 music company. One is to look at the cost that
15 they've incurred as a result of their participation in
16 the sound recording process.

17 There are two methods. One is to
18 look -- of measuring the relative contribution of the
19 record companies and the music publishers. One is to
20 look at the cost incurred by the parties as a result
21 of their participation in the process, the sound
22 recording process. And I refer to that as the

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1 cost-of-production method. The second is to measure
2 their contribution by the income they earn or derive
3 as a result of their participation in the process.
4 And that's called the factor-income method. Both are
5 legitimate ways of measuring the value of a
6 contribution.

7 Q I'll ask you to go to the next slide, and
8 briefly describe the cost-of-production method.

9 A Under the cost-of-production method the
10 ratio of the license fees for the record companies and
11 the music publishers would be equal to the ratio of
12 the cost incurred by the two parties participating in
13 the process as illustrated on that slide. And this is
14 consistent with how rates would be set in a long-run
15 competitive market, an equal agreement, what the equal
16 agreement result would be.

17 ARBITRATOR VON KANN: I couldn't hear that
18 last answer.

19 THE WITNESS: I'm sorry. This
20 ratio -- this arguing of this ratio applies -- is
21 consistent with how rates would be set in a
22 competitive market in the long run, under long-run

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1 equilibrium.

2 BY MR. GARRETT:

3 Q Let me ask you to turn to the next slide.

4 MR. GARRETT: I think we need to go into
5 restricted session at this point, Mr. Chairman.

6 CHAIRMAN VAN LOON: Okay. We'll ask that
7 the transcript be restricted and the sign be changed
8 outside the door.

9 (Whereupon, at 10:36 p.m., the proceedings
10 went into Closed Session.)

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1 CROSS-EXAMINATION

2 BY MR. RICH:

3 Q Hello, again, Dr. Schink.

4 A Hello.

5 Q Now, you critique Professor Jaffe's fee
6 model patterned after the radio broadcast industry's
7 fee experience with ASCAP, BMI and SESAC; is that
8 correct?

9 A Well, I'm critical of the fact that he
10 didn't use the benchmark as it was defined.

11 Q I'm having trouble hearing you.

12 A I'm critical of the fact that he didn't
13 use the benchmark that's actually used in that arena.

14 Q When you say "arena," by the way, do you
15 use that synonymously with marketplace, or what do you
16 mean by arena?

17 A I think you could say it's synonymous with
18 marketplace.

19 Q Is that an economist term of art, arena?

20 A It's a term of art that I have come up
21 with, but I will say market if you would prefer.

22 Q You're testifying.

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1 Let me ask you, what study have you made
2 of the radio industry's relationships with the
3 performing arts organizations, whether in connection
4 with this rebuttal testimony or otherwise?

5 A Well, I've certainly looked at the various
6 contracts that are between the performing rights
7 organizations and the -- and broadcast radio, not all
8 of them but certainly some of them. I've looked at
9 the information available on the Web site. I've
10 looked at selected cases involving court -- cases
11 involving the PROs and the broadcasters.

12 Q What cases are those?

13 A I think the cases -- certainly the cases
14 I've cited in my testimony and possibly others. But
15 I -- I read a number of cases in preparation for this.
16 I can't cite the ones that I -- I read recent major
17 cases I think over the last four or five years.

18 Q Do you have a handy reference to the cases
19 you cite in your testimony?

20 A I think they're in my work papers
21 somewhere. I know they're in there. Somewhere is the
22 problem.

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1 Q Is it your understanding that it's in the
2 testimony proffer or in the work papers underlying
3 your testimony?

4 A Well, in the work papers there, I think,
5 are copies of the decisions in most cases. And if you
6 have one, I can look to see if I can find it quickly.

7 Q I just didn't see any reference in your
8 testimony. I thought you were indicating you made
9 reference to one or more cases in your testimony
10 proffer.

11 A Maybe I intended to and didn't.

12 Q Well, we don't need to burden --

13 A Well, if I didn't, I didn't. I had read
14 some --

15 Q What industries did the cases that you
16 reviewed pertain to?

17 A The radio broadcasts. The issues related
18 to the rates being sent by BMI and ASCAP in the radio
19 broadcast arena.

20 Q Specifically in the radio broadcasting
21 industry?

22 A Correct.

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1 Q Have you read any rate court opinions
2 pertaining to the broadcast television industry?

3 A No, I did not.

4 Q Cable television industry?

5 A No.

6 Q Are you familiar with the recently
7 effective amended ASCAP consent decree which sets
8 forth the rate regulation of ASCAP?

9 A I -- I may have looked at it, but as I sit
10 here, I can't remember it.

11 Q Is it your practice as an expert in
12 regulated industries and rate regulation to keep
13 current with salient developments? For example, when
14 and if the United States Department of Justice enters
15 into a modification of a consent decree with a major
16 industry involving rate regulation.

17 A Generally, yes.

18 Q But you've not had occasion to review the
19 ASCAP decree modification, I'll represent to you,
20 effective September 2001?

21 A I think I have probably looked at it, but
22 I can't say for sure.

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1 Q And what do you recall from reviewing it
2 in terms of any potential relevance to this
3 proceeding?

4 A As I sit here, I cannot recall
5 specifically any -- I cannot recall any specific item.

6 Q Now, you make reference to two types of
7 ASCAP and BMI license arrangements, a so-called
8 blanket license and a so-called per-program license;
9 is that correct?

10 A That's correct.

11 Q What's your understanding of the
12 conceptual differences between the two?

13 A Well, a blanket license is -- would be
14 used by a radio station that essentially was all
15 music. The per-program license would be used by a
16 radio station that had some music programming and some
17 other programming.

18 Q Is that total understanding on your part
19 of the differences between the two licenses?

20 MR. GARRETT: I'm sorry. Are you asking
21 conceptually or are you asking about the specific
22 rates?

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1 MR. RICH: At the conceptual level.

2 THE WITNESS: Well, conceptually, the
3 intent is to provide a vehicle -- the blanket license
4 applies -- would apply conceptually to a radio station
5 that, in fact, would have the bulk or most of its
6 revenues related directly to music play. The
7 per-program license, my understanding, was derived to
8 cover those stations for which music play was a
9 smaller part of their total -- was not their total
10 programming but was part of their program offering.
11 And it, in essence, allowed the -- those stations that
12 weren't fully -- whose revenue wasn't fully due to
13 music but was due, in part, to it, to pay a rate only
14 on a part of the revenues that was related to
15 performance of music.

16 BY MR. RICH:

17 Q I take it from your earlier answer,
18 respecting the amended ASCAP decree, that you're not
19 familiar with what that decree now provides for
20 forward-looking licenses between ASCAP and the radio
21 industry, respecting the relative rates of a
22 per-program and a blanket license?

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1 A I can't say -- no, I do not.

2 Q Would it be the first time you will have
3 heard it if I represent to you that with respect to
4 radio broadcasters, future ASCAP licenses mandate that
5 the radio per-program fee structure be in line with
6 the blanket license fee structure so that for a
7 typical radio broadcaster it should be a matter of
8 economic indifference as to which fee structure it
9 adopts? Is that the first time you've heard that
10 characterization of the decree?

11 A It's the first time I've heard that
12 characterization, yes.

13 Q And if you will accept, for purposes of my
14 question, my representation that that is true, and had
15 you had that information at the time you prepared your
16 rebuttal testimony, would you have found that
17 information of relevance, at least to that portion of
18 your testimony that deals with the per-program
19 license?

20 A I would certainly want to have tried to
21 determine what it meant. I don't -- I would have to
22 look at the details of it to see if I could infer what

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1 the -- what it really implied. I mean, I don't think
2 what you're saying necessarily says the rates have to
3 be the same, but I haven't studied it, so I can't
4 tell. It would have been useful to look at, yes.

5 Q I take it, though, with specific reference
6 to your footnote 2 appearing on page 5, that you would
7 not knowingly recommend that this panel adopt, if it
8 were to follow in the general direction of Dr. Jaffe's
9 thinking, a per-program rate that would run counter to
10 the requirements of any new government consent decree
11 with ASCAP, would you?

12 A I -- well, I'm not advocating this
13 approach at all. But Professor Jaffe was doing his
14 analysis in the context of 2000. So to the extent
15 that we're saying what was the situation in
16 2000 -- this was the situation -- and to the extent we
17 want to be forward-looking and say, let's take into
18 account where this is going, you'd want to factor that
19 in if you were going to, in fact, propose a
20 per-program rate.

21 Q You would simply want to factor in a
22 requirement of a government consent decree with ASCAP

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1 or you would want to make sure that the panel was
2 scrupulous in following its dictates? Which one is
3 your opinion?

4 A Well, you'd want to, basically, if you
5 were going to define a per-program fee, to presumably
6 look at what the newest decision is and would try to
7 follow it.

8 MR. GARRETT: Excuse me. Do we need the
9 slide projector for your purposes?

10 MR. RICH: No.

11 CHAIRMAN VAN LOON: I was thinking we
12 might turn that off.

13 MR. JOSEPH: I may find it useful to refer
14 to some of the slides when it's my turn. So I'm happy
15 to have it come down and then go back up.

16 CHAIRMAN VAN LOON: Why don't we do that
17 so we can see the clock.

18 MR. RICH: Just one or two more.

19 MR. GARRETT: I thought it might be lunch.

20 BY MR. RICH:

21 Q Just one or two more questions about the
22 per-program license. What is your understanding as to

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1 how a fee is triggered with respect to a radio
2 broadcaster operating under a per-program license?
3 What use or uses of music trigger a per-program
4 payment, to your understanding?

5 A My understanding is that it would be a
6 case where a radio broadcaster had specific segments
7 of its program where it did not contain the
8 relevant -- the music would be covered by, where I
9 would say, you'd have to pay such a fee, and the radio
10 station, I presume, would apply for a per-program
11 license. They'd make the decision on which to apply
12 for, based on which one would cost them less money.

13 Q With respect to any particular program
14 that contains ASCAP music, do you have an
15 understanding whether the per-program fee varies in
16 relation to the number, say, of feature performances
17 of music that occur within that program?

18 A Whether or not the number of performances
19 of music -- could you restate that? I'm having a hard
20 time following.

21 Q The question is whether you have an
22 understanding whether the numbers of occurrences of

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1 feature performances of music in a given program
2 affect the per-program license fee payable by a radio
3 broadcaster operating under that license?

4 A I don't know.

5 Q When was the last time you had occasion to
6 review the per-program license, or licenses, which are
7 the subject of footnote 2 of your testimony?

8 A I've looked through them in preparing the
9 testimony. That particular item, I don't recall
10 that -- the point you're raising I do not recall.

11 Q Now, you criticize -- if you'd look at
12 paragraph 11 of your testimony, please, you calculate
13 the percentage of revenue payable by over-the-air
14 broadcasters to ASCAP, BMI and SESAC combined, based
15 upon the fee of 1.615 percent as to ASCAP and
16 1.605 percent as to BMI, of what you term a radio
17 station's net advertising revenue; is that correct?

18 A Correct.

19 Q And then you add a small sum in addition,
20 an imputed percentage for SESAC, correct?

21 A Correct.

22 Q Totaling 3.32 percent, yes?

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1 A Correct.

2 Q Now, when you use the term "net
3 advertising revenue," what do you mean?

4 A It's the revenue net of discounts, bad
5 debts. There are some other specific items that are
6 listed in the contracts that are excluded, and I can't
7 as I sit here recall them all.

8 Q And did you attempt to compute what impact
9 that had -- did you attempt to convert these net
10 revenue numbers into gross revenue equivalents?

11 A Gross revenue equivalents for the record
12 company? For the --

13 Q No, for the radio industry.

14 A No, I did not.

15 Q Do you have any sense sitting here today,
16 from having reviewed the definitions of net revenues
17 that govern these contracts, what the effective
18 royalty rate would be if one attempted to state that
19 rate in terms of gross rather than, as defined, net
20 revenues?

21 A No, I do not.

22 Q Professor Jaffe in his rebuttal testimony

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1 makes such an estimate. And this is at page 36 and
2 including note 43 --

3 MR. GARRETT: Do you have a copy?

4 MR. RICH: I'm happy to provide the
5 witness with my own, if I may.

6 MR. GARRETT: Sir, what's the page?

7 MR. RICH: Page 36 and note 43.

8 And if you would look at that and whatever
9 other portions you would like, you'll see that --

10 CHAIRMAN VAN LOON: Can you state, again?
11 I'm sorry, Mr. Rich.

12 MR. RICH: Page 36 and note 43 on page 36.

13 And you'll see that he estimates that in
14 gross revenue terms the combined fees approximate
15 3 percent. And my question is, do you have any reason
16 to disagree with that estimate?

17 THE WITNESS: Oh, I see what he's doing.
18 I have no basis to agree or disagree. I'd have to
19 study this. I don't know if it's right or wrong.

20 BY MR. RICH:

21 Q So you made no effort to quantify the
22 effect of the stated deductions from gross revenue

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1 that appear in the ASCAP and BMI contracts, the
2 blanket license contracts; is that correct?

3 A No, on the -- I've stated the percentages
4 as percent of net revenue. So I -- I mean, I've
5 always been using them as a percent of net revenue
6 type concept.

7 Q Is it fair to say that the definitions of
8 net revenue appearing in the ASCAP and BMI contracts
9 are somewhat complex and perhaps even convoluted?

10 A I can't really respond to that. It's a
11 matter of accounting. If you keep track of the things
12 you're supposed to deduct, I don't suspect -- it's a
13 matter of subtraction. I don't -- I don't know that
14 they're complicated to track or not.

15 Q Did you derive an opinion whether the
16 required computations make those computations right
17 for an audit and review by auditors?

18 A I certainly haven't investigated whether
19 or not the -- no, I have not looked at that.

20 Q Now, have you had occasion to consider
21 what the net revenue analog would be were a 3 percent
22 or a 3.32 percent fee carried over into the webcasting

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1 environment?

2 A I'm not sure I fully understand your
3 question.

4 Q Assume hypothetically that the panel
5 adopted part, but only part, of your methodology, and
6 they were to conclude that for various
7 problems -- asserted problems -- with the conversion
8 from the over-the-air percent-of-revenue experience to
9 a per-listener song metric, that they would prefer to
10 work from your stated -- or some variation of your
11 stated analysis -- of the effective over-the-air
12 percentage. Okay? With me so far?

13 A Yeah. They would elect to use a
14 percentage.

15 Q Okay. And let's just work with your
16 3.32 percent of net revenue. That's what you
17 computed, correct?

18 A Correct.

19 Q That is, based on your best understanding
20 and your best analysis, a faithful statement of the
21 combined royalty percentages, as defined as net
22 revenues per the contracts, payable by radio

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1 broadcasters for access to the entire repertories
2 combined of ASCAP, BMI and SESAC; is that correct?

3 A That's correct.

4 Q Okay. Now my question is, if the panel
5 were so inclined and said, that sounds right, that's
6 less problematic than converting, do you have a
7 recommendation today how they could take that
8 percentage and apply it in the webcast setting to the
9 "net revenues" of webcasters? How would you in that
10 situation recommend to the panel that they define
11 equivalent "net revenues"?

12 A I haven't looked at that.

13 Q Something you haven't thought about.

14 A I haven't looked at -- no, I
15 haven't -- I've not done that.

16 Q If one were able, staying with a
17 percent-of-revenue concept, to articulate the
18 over-the-air radio experience in terms of a gross
19 rather than net revenue percentage -- whether the one
20 suggested by Professor Jaffe to be applicable or
21 otherwise -- would you agree with me that as a matter
22 of reporting and recordkeeping, working from a gross

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1 rather than some complicated net revenue reporting
2 figure would be more desirable?

3 A It would be easier; I don't know that it's
4 more desirable. By taking the adjustment that
5 Professor Jaffe proposed, he, again, calculates a
6 relationship in the broadcast radio arena, and then
7 argues you can take the relationship between net and
8 gross revenues, I guess, or he implicitly is arguing,
9 at least, that I'll calculate the relationship between
10 net and gross revenues in the radio broadcast arena
11 and assume the same relationship applies in the
12 webcasting arena. And I don't know that that's
13 correct. I certainly don't think it would be
14 appropriate to make that assumption, just as I don't
15 think it's appropriate to make the assumption that the
16 radio broadcasting arena and the webcasting arena are
17 the same.

18 Q Do I understand at least the portion of
19 your testimony that criticizes Professor Jaffe's
20 converting the actual fee experience, or the actual
21 method of reporting fees, based on percentage of
22 revenue -- do I take it to be, or at least so much of

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1 your testimony to be, that if, contrary to your
2 overall recommendation, the panel were persuaded by

3 Q Do I understand at least the portion of
4 your testimony that criticizes Professor Jaffe's
5 converting the actual fee experience or the actual
6 method of reporting fees based on percentages of
7 revenue?

8 I take it to be -- at least so much of
9 your testimony to be that if, contrary to your overall
10 recommendation, the Panel were persuaded by the fee
11 level pertaining in the radio industry, and sought to
12 apply it in the webcasting arena, that from your own
13 perspective the preferable way to do that is to retain
14 a statement of those fees as a percentage of net
15 revenues, however one might define those?

16 A Again, my view would be that if you're
17 going to argue that the radio broadcast benchmark is
18 what I want to move over, I would argue that unless
19 you can demonstrate specifically that it's not
20 appropriate to move an attack, you shouldn't move an
21 attack.

22 Q But sitting here today, you would not have

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1 any recommendations about how to define webcaster net
2 revenues to make an apples to apples comparison, is
3 that correct?

4 A That's correct.

5 Q And, incidentally, do you have any idea if
6 a 3.32 percent of net revenue fee were applied to the
7 economic circumstances of webcasters today, whether
8 that fee on average would be higher or lower than the
9 fee that would be generated by Professor Jaffe's per
10 listener song fee?

11 A I want to make sure I understand the
12 question. You're saying if I took the 3.32 percent
13 and applied it to revenues of webcasters, do I know
14 today whether it would be -- reduce a per listener
15 hour or per listener song number higher or lower than
16 Professor Jaffe's?

17 Q No, different question. Whether it would
18 result in license fees to the recording industry
19 greater or lesser than the fees that would be
20 generated by the application of Professor Jaffe's per
21 listener song or listener hour model.

22 A I'm sorry. But I am totally lost at the

1 question.

2 Q I take it -- let's take it in baby steps.

3 A Okay.

4 Q I take it one could take the percentage
5 which you say faithfully represents the amounts
6 payable by over-the-air radio broadcasters to the
7 licensing organizations, namely 3.32 percent of net
8 revenue --

9 A Right.

10 Q -- and could apply it to some revenue
11 number applicable to each of the services involved in
12 this proceeding, correct? And you could, therefore,
13 arrive at a license fee, yes?

14 A Applicable to each service?

15 Q Yes.

16 A You could apply it, yes. Yes, you could
17 apply it.

18 Q It's a matter of math, right?

19 A It's a matter of math.

20 Q Likewise, you could take Professor Jaffe's
21 converted metric of .0022 -- let's leave out the
22 promotional discount for the moment -- and you could

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1 apply that against the data in evidence as to the
2 numbers of performances of sound recordings occurring
3 with respect to each service, is that correct?

4 A You could do that math, yes.

5 Q And my question is: do you know, sitting
6 here today, going down the list of services involved
7 in this proceeding, which of those computations would
8 yield a higher license fee to the recording industry?

9 A No, I do not.

10 Q It's nothing you've examined?

11 A No.

12 Q And it's a matter of no moment to you, I
13 take it, right?

14 A It's not a matter of no moment. It's a
15 question of whether -- as I've said I think in my
16 testimony, the experience -- the current experience of
17 most of these companies is --

18 Q I can't hear you, sir.

19 A The current situation for most of these
20 webcasters who want to start up, and their current
21 revenues are -- can be very, very small today. In
22 fact, some of them have no revenues -- I think were a

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1 part of this proceeding. So what I'm arguing is you
2 should look forward to a -- at least past the break-
3 even point or even to the mature webcaster point to
4 get some sense of what the fees would be.

5 If you looked at it today, it's given that
6 a combination of these are making little or no
7 revenue. It's quite possible that Professor Jaffe's
8 numbers will produce a higher result, but I don't
9 think that's relevant because we're talking about
10 startup industries with very little revenues and not
11 -- and not the sort of situation that's --

12 Q And just so we're entirely clear, if the
13 Panel were to determine that the over-the-air radio
14 music license works experience is directly germane to
15 fee setting and should govern fee setting here, I take
16 it, notwithstanding that you've made additional
17 adjustment recommendations, that if that's as far as
18 the Panel determined it was appropriate to go, it
19 would be your recommendation that the metric to use is
20 3.32 percent of the net revenues paid by the radio
21 industry to ASCAP, BMI, and SESAC, am I correct?

22 A Well, the metric I'm suggesting is a

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1 percentage metric that if you are going to adopt that
2 metric as a benchmark, as Professor Jaffe has done and
3 move it over, that what you should move over is the
4 3.32 percent.

5 Q Just a small point in footnote 1 of your
6 testimony at page 5.

7 A Yes.

8 Q Have you reviewed any of the pleadings in
9 the pending BMI rate proceeding with the over-the-air
10 radio broadcast industry?

11 A I don't recall reading any.

12 Q Are you familiar with the bid and asked so
13 to speak in that proceeding in terms of the fee levels
14 and fee structure sought, respectively, by the radio
15 broadcasters on the one hand and BMI on the other?

16 A No, I'm not.

17 Q Sitting here today, do you have an opinion
18 whether the outcome of that proceeding is likely to
19 result in a higher or lower fee than the prevailing
20 1.605 percent fee?

21 A Without having studied it in detail, my
22 understanding it's possible it could be higher or

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1 lower.

2 Q Are you aware that the radio broadcasters
3 in that proceeding are seeking to establish blanket
4 license fees with BMI that are not determined as a
5 percentage of their advertising revenues?

6 A I wasn't specifically aware of that, no.

7 CHAIRMAN VAN LOON: I'm sorry, Mr. Rich.
8 Did you say the broadcasters were asking --

9 MR. RICH: Yes, in the pleadings in that
10 case.

11 CHAIRMAN VAN LOON: Okay.

12 BY MR. RICH:

13 Q Now, am I correct, Dr. Schink, turning to
14 pages 6 and 7 of your written direct -- written
15 rebuttal testimony, that -- again, staying with my
16 prior question for a moment -- the discussion you make
17 and the contents of Appendix A are designed to address
18 the circumstance, but only the circumstance, where the
19 over-the-air broadcast fee is translated, as Professor
20 Jaffe has done, into a listening hour fee, is that
21 correct?

22 A Appendix A addresses both listener hour

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1 and listener song.

2 Q Let me amend my question to incorporate
3 that. Am I correct?

4 A Yes, it addresses that.

5 Q And that the methodological suggestions
6 there would be irrelevant insofar as the Panel were to
7 otherwise find that the musical works analogy is
8 appropriate, so long as that musical works analogy was
9 stated, as you recommend, as a percentage -- as a
10 faithful percentage of revenue reflecting the
11 experience of the radio industry, correct?

12 A Yes. Appendix A deals with the
13 restatement of the benchmark and per listener song or
14 per listener hour -- not with the 3.32 percent.

15 MR. JACOBY: Excuse me. I just noticed
16 that the sign is listed as closed session, and I don't
17 know -- we've been on closed session and probably
18 didn't need to be.

19 CHAIRMAN VAN LOON: Thank you, Mr. Jacoby.
20 That's helpful. Let's make it open.

21 And, John, could you please go back to the
22 beginning of Mr. Rich's cross examination.

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1 MR. RICH: Thank you very much.

2 BY MR. RICH:

3 Q Now, with respect to that discussion
4 respecting conversion, you first criticized Professor
5 Jaffe for not taking at face value the manner in which
6 the fee was articulated in the ASCAP and BMI
7 agreements, namely as a percentage of revenue,
8 correct? In other words, the very notion of
9 converting that fee here you find fault with, is that
10 correct?

11 A That's correct. That's not what was
12 negotiated between the parties.

13 Q Now, technically, although it's a
14 relatively minor point, you would concede that that
15 criticism is not valid or at least isn't completely
16 valid as to the SESAC fee experience, which I believe
17 you indicated in response to a Panel question is not
18 stated with respect to radio broadcasters as a
19 percentage of revenue fee, correct?

20 A It's not stated in that form, no.

21 Q You said it was implicit, or words to that
22 effect, correct?

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1 A That's correct.

2 Q Okay. Two out of the three, though, are
3 explicitly stated as percentage of revenue, correct?

4 A Yes, and they account for about 97 percent
5 of the catalog.

6 Q And where did you get the three percent
7 from, by the way?

8 A That's basically estimated by talking to
9 my colleagues, again, in the -- in the -- who work
10 with BMI and ASCAP, and also to -- or had worked with
11 BMI and ASCAP, and also looking at the websites of the
12 three. The estimates are rough. I think one is --
13 BMI I think is four and a half million, ASCAP is four
14 million, and I think SESAC's is hundreds of thousands.
15 And that works out somewhere in the neighborhood of
16 three percent.

17 Q By those references, you're referring to
18 the size of their musical works catalogs, reportedly?

19 A That's correct.

20 Q And that's the basis on which you
21 estimated the three percent, together with other
22 anecdotal evidence?

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1 A Yes.

2 Q Now, is it your understanding that in
3 making his conversion Professor Jaffe was attempting
4 to replicate precisely for every radio broadcaster the
5 fee experience it had -- strike that. Let me try it
6 again.

7 Is it your understanding that in
8 undertaking his conversion it was Professor Jaffe's
9 objective to come up with a conversion metric which
10 applied to each and every over-the-air radio
11 broadcaster would generate precisely the fees that
12 broadcaster has paid ASCAP, BMI, and SESAC, is that
13 your understanding?

14 A I'm not entirely -- I mean, I can't speak
15 to his intention. I think he makes the claim that all
16 that matters is that it works for the average, which
17 I don't agree with.

18 Q And when you say, "All he contends is it
19 works for the average," I believe in response to Judge
20 von Kann you did agree that taking his average and
21 applying it -- if you were to take his conversion rate
22 of .0022 and apply that across the circumstances of

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1 all over-the-air radio broadcasters who were part of
2 his sample of 900, is it correct, as a matter of math,
3 that the resulting total license fees that would be
4 generated by that would be equal to the reported
5 license fees actually paid to those societies?

6 A If you summed up the listener hours for
7 all 900 stations and produced a total number of
8 listener hours and multiplied that by what -- let me
9 do .22 cents. I've got too many O's in this. That
10 would produce the sum of the license fees paid by all
11 of those radio stations.

12 Q And your --

13 A As a matter of math.

14 Q Yes, as a matter of math. And your
15 criticism, however, is that if you parse that more
16 finely within genres of stations, there is the degree
17 of variation you've observed and you've put forth in
18 your various appendices, is that correct?

19 A Yes, that's I think fair.

20 Q And is it not the case, as I think also
21 came out on examination by Judge von Kann, that the
22 reason that one sees the disparities within genres,

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1 or, indeed, would see them within stations, is more a
2 function of how station revenues vary per listener
3 than it is based on how their particular music use
4 experience may vary?

5 A Yes, I can't -- you can't argue that if a
6 station plays more or less music it's going to have
7 more or less revenue per listener.

8 Q And I believe you testified that there is
9 a very weak, slight if you will, relationship -- you
10 were even stronger I think -- you said there is
11 basically -- let me get your words that I took down --
12 you said there's no relation whatsoever between
13 revenue and music use in your observation, is that
14 correct?

15 A I am certainly aware of none.

16 Q You're aware of none. And that being --

17 MR. GARRETT: I'm sorry. You said music,
18 do you mean the amount of music?

19 THE WITNESS: I was assuming he's meaning
20 the number of songs played per hour.

21 MR. GARRETT: Amount of music use, okay,
22 and --

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1 THE WITNESS: Number of songs played per
2 hour.

3 BY MR. RICH:

4 Q So you would agree that the revenues
5 generated by any particular over-the-air radio
6 broadcaster are driven by any number of variables,
7 some having little or nothing to do with the actual
8 selection of or volume of music played, is that
9 correct?

10 A No, I wouldn't go that far.

11 Q How far would you go?

12 A Well, the selection of music that you
13 play, and I think the way you present the music, the
14 way you mix it with your other programming, affects
15 the attractiveness of your radio station. And it --
16 so the choice of music you play, the sequence in which
17 you play them, how you organize it, all the things
18 that go to make a radio station more or less popular
19 with a given group of listeners, factor into it.

20 But I think if -- what I think I'm saying
21 is that if you just told me that one radio station
22 played 10 songs an hour and another one played 12, I

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1 couldn't tell you anything -- I couldn't, based on
2 that, with any confidence tell you anything about what
3 the relative revenues per listener hour would be.

4 Q And so, if I understand your testimony,
5 you would agree that important contributors to the
6 revenue success of a station would be, for example,
7 the charismatic qualities or lack thereof of one or
8 more disc jockeys, correct?

9 A That's certainly a factor.

10 Q The creativity of a program director in
11 selecting music, correct?

12 A That's correct also.

13 Q The reach of the signal, the quality of
14 the transmission potentially, yes?

15 A In terms of size of audience, yes.

16 Q Yes. And conceivably other factors that
17 -- that we would point to that have nothing per se to
18 do, as you say, with the amount of music that is being
19 broadcast, correct?

20 A Measured by just a count of songs per
21 hour, yes.

22 Q Yes. Now, at the same time, what is your

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1 understanding of what a performance right under the
2 copyright law entitles the copyright owner to
3 compensation for?

4 A Compensation for the -- you know, the
5 benefit that the copyright user obtains from using the
6 right.

7 Q From using the right. And, specifically,
8 that right is triggered by what activity, to your
9 understanding?

10 A The use of the right.

11 Q Use of music.

12 A Use of music.

13 Q So that all other things equal, you would
14 agree that the more music a broadcaster or any entity
15 performs, one would presume that would give rise to a
16 greater rather than a lesser entitlement to music
17 performing rights or sound recording rights performing
18 payments to the relevant copyright owners, correct?

19 A I don't think it's relevant use. I think
20 it's relevant value. And I think, you know, what's
21 the relevant value of the music and the process, and
22 that's not simply determined by how many songs you

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1 play in the hour.

2 Q You're not suggesting that that metric is
3 irrelevant, are you, namely the measure of amount of
4 music performed to the value of music performance fees
5 to be paid to a copyright owner? Or are you?

6 MR. GARRETT: I'm sorry. Just to be
7 clear, are you asking this as an economist or under
8 Section 114 in particular?

9 MR. RICH: Economist. He's here as an
10 economist.

11 THE WITNESS: As an economist, what's
12 relevant is the value of the contribution, not how
13 many times a song is played or how many times songs
14 are played.

15 BY MR. RICH:

16 Q And so is it your view that revenue is, in
17 fact, a better proxy for the value of the performing
18 right than a measuring technique such as per listener
19 song or per listener hour that attempts directly to
20 measure the numbers of performances of the musical
21 works themselves?

22 A Well, I think that that has been at least

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1 the result of negotiations between the parties. The
2 parties seek -- parties to these negotiations and the
3 radio broadcast arena I think seek -- are seeking what
4 they view as the best measure to use.

5 The broadcasters are arguing one way, the
6 performance rights organization another, and I think
7 at least today, and certainly in 2000, the agreement
8 between the parties had been that the best way to
9 measure it was, in fact, percentage of revenues.

10 And I -- I'm not going to try to -- as an
11 economist, to judge -- to judge where -- you know,
12 say, well, I -- I certainly can't say I have a better
13 way of doing it. And I'm certainly not going to try
14 to say that I can do a better job of -- as I sit here
15 of -- infer how a market should work than the people
16 who are, in fact, actively engaged in it.

17 Q But surely you understand that at least
18 Professor Jaffe's objective -- you may disagree with
19 how he went about trying to attain it -- wouldn't you
20 agree that his objective was by looking at an
21 established music licensing marketplace to attempt to
22 discern the correct measure of value of that music,

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1 for purposes of translating that into a new music
2 marketplace, you understand that to be his objective,
3 yes?

4 A That's what he was -- that's what he
5 claimed that he was doing. He's assuming that the
6 value is independent of the way in which it is used or
7 independent of the context in which it is used. And
8 I don't believe that's correct.

9 Q Do you understand him to be saying it's
10 independent of the context, or that he is expressing
11 an opinion, with which you may well disagree, as to
12 what the relevant measure of value is coming out of
13 the radio broadcast experience?

14 A I'm having a hard time figuring -- would
15 you break that in small pieces for me, because I'm not
16 sure what I'm answering.

17 Q I thought it was one concept. I'll be
18 happy to try it again.

19 A Okay.

20 Q You criticize Dr. Jaffe's methodology.
21 Indeed, at one point, you I think perhaps unfairly
22 suggest that his view was, "Oh, it doesn't matter if

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1 you get it right because it's too small to matter."
2 But passing that, do you agree that -- that what his
3 effort is in his testimony and rebuttal testimony is
4 to extract from the radio broadcaster's fee
5 experience, in what he regards to be a highly
6 analogous licensing marketplace, a measure of the
7 value of performances in a way that would be helpful
8 to this Panel in thinking about setting performance
9 valuation here. Do you agree that's what he was
10 attempting to do, whether or not you agree with
11 whether he accomplished that?

12 A I find it hard to speak as to what he was
13 trying to accomplish. I mean, he argues I think that
14 they are comparable and I -- I don't think they are.
15 So I -- I mean, I -- I really can't speak to what his
16 intent was, I don't think.

17 Q Putting aside your inability to agree with
18 that proposition, you appear to say that if you're
19 going to look at that experience you should look at it
20 in terms of a percent of revenue metric, that because
21 the fees radio broadcasters agreed to pay ASCAP, BMI,
22 and SESAC ultimately were expressed as a percent of

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1 revenue, that if any concept is to be imported into
2 the webcasting arena from that experience, it must be
3 that equivalent, or in your case a four to six times
4 multiple of that percentage of revenue, should be the
5 right way to view it, correct? That's the gist of
6 your testimony.

7 A Well, it's correct that I'm arguing that
8 the percentage of revenue should be used, but I'm
9 arguing that that is, in fact, how it is done in the
10 benchmark that Professor Jaffe purports to use, and
11 that what he has done in calculating the per
12 performance rates is to create something that is not,
13 in fact, part of the benchmark that he claims to be
14 using.

15 Q Separate and apart from whether it's part
16 of the benchmark, do you have an opinion as to the
17 validity of using, as a basis for fee setting in this
18 proceeding, a fee keyed not to webcaster revenues,
19 which you have conceded have little or anything to do
20 with music use, but rather a fee based on the actual
21 usage of that music and the listenership that's
22 attracted to it. Do you have a view whether that's a

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1 good idea or a bad idea as a matter of economics?

2 A I'm having a problem with whether I
3 concede it as part of that question.

4 (Witness laughs.)

5 Q Strike that from my question.

6 A I was asked -- you know, you'd better look
7 at my assignment and my view and my position in this
8 case. I was asked to say, okay, if we're going to use
9 a radio -- if the Panel were to decide it wants to use
10 a radio broadcast benchmark, how should Professor
11 Jaffe's approach be amended?

12 And I -- I believe that if, in fact, it
13 wants to start -- if it were to choose to start with
14 a radio broadcast benchmark and use that, it should
15 use the percentage benchmark. And that Professor
16 Jaffe's calculations in fact produce something which
17 is not that benchmark, and, therefore, it's not -- you
18 know, if they like -- you know, it should no longer be
19 cloaked in a radio -- you know, as a radio broadcast
20 benchmark. It's something else. I don't know what it
21 is, but --

22 Q Are you familiar with the fee positions of

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1 the RIAA in this proceeding?

2 A What they're proposing.

3 Q Are you?

4 A Yes.

5 Q And are you aware that they, in the
6 alternative, are proposing a percentage of revenue fee
7 as well as a -- something that we might say is closely
8 tied or allied to the per listener song fee proposed
9 by Professor Jaffe?

10 A Yes, I'm aware that they have this
11 proposal.

12 Q Okay. And, really, my question was going
13 to whether you, as an economist, have an opinion as to
14 which approach to fee setting is preferable. Is it
15 your view, in the face of the comments you've made
16 about revenue and its relationship to music use, that
17 it is, nevertheless, preferable to utilize a
18 percentage of revenue approach to fee setting for the
19 sound recording performing rights, as in one
20 alternative proposed by the RIAA, or whether,
21 consistent with Professor Jaffe's view, it may be
22 preferable to use a measure which directly meters

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1 actual usage of music and how many listeners it
2 touches?

3 MR. GARRETT: Just so we're clear, are you
4 asking whether it's preferable -- one to the exclusion
5 of the other?

6 MR. RICH: I'm asking if he -- if he would
7 rank order them in terms of economic desirability.

8 THE WITNESS: I don't -- there is no rank
9 order based, in the abstract, on economic
10 desirability. I think there's a major difference
11 between -- you know, if what has happened in the
12 webcasting context, the -- as I understand it, is that
13 the RIAA -- sort of dual-pronged proposal of a percent
14 rate and a per performance rate, is the result of the
15 outcome of negotiations between the RIAA and 26
16 webcasters, and that they -- the parties have in that
17 marketplace agreed to -- you know, you could have
18 either a percentage or you could have a per
19 performance rate.

20 Now, if the parties -- you know, it's not
21 -- if the parties in the agreement feel -- you know,
22 to the agreement feel that it's -- you know, that it's

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1 appropriate to have this two-pronged approach, I, as
2 an economist, can't say that the people running these
3 businesses don't know what they're doing. I certainly
4 don't -- you know, they can't arrive at it.

5 And, conversely, if BMI and ASCAP had such
6 a dual-pronged program, if they had a fee per listener
7 hour fee, that you'd bet the broadcasters could select
8 as an alternative to the percentage, and Professor
9 Jaffe took this negotiated rate and used it, I could
10 -- I would have to say, okay, that's consistent with
11 his benchmark.

12 But they don't. There is no per
13 performance fee in the broadcast radio arena. So
14 there's a big difference between Professor Jaffe
15 sitting and calculating something, which he then
16 claims is the same, and the RIAA and the webcasters
17 negotiating the two-pronged approach, which both find
18 acceptable. Whether they find it the same or not,
19 they find this two-pronged approach acceptable.

20 BY MR. RICH:

21 Q Okay. So, conceptually, you don't have a
22 problem with a per performance fee. You have a

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1 problem with the technique by which Professor Jaffe
2 came about his per performance fee, is that right?

3 A I have a problem with anyone calculating
4 a license -- change in the metric of a license like
5 that in a way that clearly changes -- would change
6 what the parties to a market would pay dramatically,
7 and arguing that there's no difference between the
8 two, or the party -- he's implicitly saying in his
9 calculation -- you know, not explicitly, but
10 implicitly implying that the parties in the broadcast
11 arena should find -- or should be indifferent between
12 what they actually do, their percentage of revenue
13 approach, and the per performance rate. And my
14 understanding -- is there anything but a difference
15 here that --

16 Q Did you understand that the purpose of his
17 analysis was to press upon radio broadcasters acting
18 in the broadcast marketplace an alternative
19 formulation of the fees they are to pay? Is that your
20 understanding of his exercise here?

21 A No. But implicitly he is saying that I am
22 starting -- you know, that by doing the calculation he

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1 is saying I am creating something which is no
2 different from what is actually there. And the fact
3 is it's quite different.

4 Q Now, when you analyze the conversion, an
5 aspect of the process you recommend is that whatever
6 number were utilized be applied not against -- strike
7 that.

8 Talking about Section C now, beginning at
9 page 7, bottom of page 7.

10 A Okay.

11 Q All right. And I take it that in this
12 section you indicate that one needs to look at -- this
13 is your Appendix B, not the existing revenue
14 experience of the webcasters, but what you'd term
15 "expected revenues," is that correct?

16 A That's correct.

17 Q And empirically, what data did you choose
18 to examine in going through the analysis that works
19 its way into Appendix B?

20 A In essence, we examined the information
21 that we could obtain from the record in this case on
22 what expectations were, and these were the four cases

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1 we could identify where expected revenues or break-
2 even revenues were identified.

3 Q And did you make that decision internally
4 at your economic consulting firm, or did others help
5 you in the process of determining which data to
6 utilize?

7 A We used all of the data that we could
8 find.

9 Q And did you find any data respecting that
10 radio?

11 A Obviously not.

12 Q Have you had occasion to review Dr.
13 Nagle's either direct testimony or rebuttal testimony,
14 where he performs similar estimation analyses on
15 behalf of relying on record evidence in this case?

16 MR. GARRETT: I object to the
17 characterization of similar.

18 MR. RICH: Strike similar.

19 THE WITNESS: I looked at -- I can't claim
20 to have studied his testimony in detail. I utilized
21 his estimate of what the revenue per listener hour
22 would be for a -- a mature webcaster, but I -- I can't

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1 -- I have not gone through in detail his analysis, his
2 other analysis.

3 BY MR. RICH:

4 Q Now, how reliable did you review the
5 documents which you cite as having utilized in the
6 analysis appearing in Appendix B?

7 A I tried -- I certainly tried to be careful
8 in, in fact, obtaining the data correctly. I don't
9 know what you mean by "carefully" beyond that.

10 Q When you say "obtaining the data," did any
11 of this data come from your own inquiries of one or
12 more services and your actual obtaining of data, or
13 did you rely solely on documents that were provided in
14 the context of this proceeding?

15 A I relied on documents that were obtained
16 in the context of this proceeding.

17 Q And what efforts to understand the context
18 in which those documents were created or the nature
19 and reliability of the data contained in those
20 documents did you undertake?

21 A I really can't speak to how much effort
22 the various parties made to making the projections.

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1 They were business documents used for business
2 purposes, and I assume that -- I assumed, on that
3 basis, that the people made best efforts to produce
4 the best estimates.

5 But I certainly did not try to dig into
6 what they exactly did or how they actually came up
7 with these projections.

8 Q And in your experience, how volatile is
9 the webcasting environment in terms of the durability,
10 shall we say, of financial projections month to month
11 and year to year?

12 A It's a very volatile industry. I'll agree
13 to that.

14 Q Now, how representative are the
15 projections of the four entities -- three entities, is
16 it three or four, Appendix B?

17 A Four.

18 Q Are the four entities of the anticipated
19 economic experience of the webcasting industry as a
20 whole?

21 A Well, since these are all I could
22 identify, I really can't address that. I mean, I --

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1 I can -- in terms of value of actual revenues per
2 listener hour, there are less than Dr. Nagle expects
3 for a mature webcaster.

4 I mean, the fact that the -- I mean, these
5 are, in fact, companies it appears at least that are
6 -- I'm not saying they will be successful, that some
7 won't fail, but that, in fact, they are at least
8 beyond the -- you know, they're beyond startup and
9 into business it appears.

10 Q But sitting here today, you have no basis
11 to know the degree of representativeness of the
12 industry at large of the several documents that you
13 were provided by these four webcasters, is that
14 correct?

15 A No, I cannot address whether -- whether
16 the -- whether there is some industry -- overall
17 industry average. I suspect there is not, but I don't
18 -- I can't say.

19 Q And is any of these four companies today
20 earning revenues at anywhere near the levels of the
21 projections you set forth in Appendix B?

22 A As I recall the documents, these were all

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1 significant growth -- involved significant growth from
2 where they are today.

3 Q Now, in your Appendix A, you discuss and
4 criticize Professor Jaffe's use of Arbitron average
5 quarter-hour persons data. Are you familiar with that
6 section of your --

7 A Yes, I am.

8 Q -- testimony? What is your understanding
9 as to how, if at all, Arbitron tracks those listeners
10 who listen to one or more radio stations for less than
11 five minutes?

12 A My understanding is if they don't listen
13 for at least five minutes they're not counted.

14 Q And does it appear to you, as a matter of
15 common sense, that there will be some perhaps
16 considerable number of such listeners who, therefore,
17 listen to one or more stations for less than five
18 minutes but whose listenership, therefore, is not
19 picked up in the average quarter-hour data?

20 A I don't know what that percentage would
21 be. I simply don't know the answer.

22 Q Common sense tells us there will be such

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1 people.

2 A There will be such people, yes.

3 Q Yes.

4 A But whether it's significant or not, I
5 don't know.

6 Q And you have no idea what the magnitude
7 would be if that data were captured and included in
8 listenership data compiled by Arbitron, is that
9 correct?

10 A I have no -- since Arbitron doesn't keep
11 track of it, I have no way of discerning how many
12 listen for less than five minutes.

13 Q And respecting the five- to 15-minute
14 window where you say, "Well, let's divide the two and
15 plug in 10," that's simply based on your own
16 determination to use the mean of that range as opposed
17 to any hard data provided by Arbitron or anybody else,
18 is that correct?

19 A That's correct. It presumes an even -- a
20 uniform distribution of use between five and 15
21 minutes.

22 Q But you have no knowledge whether, in

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1 fact, that average would be borne out by experience,
2 is that correct?

3 A I have no information on the distribution
4 of actual listenership between five and 15 minutes,
5 no.

6 Q Now, if you turn to note 12 of your
7 testimony on page 9, please. You criticize Professor
8 Jaffe for failing to make any upward adjustments to
9 license fees for webcast use of -- a webcaster's more
10 intensive use of musical performances than radio
11 broadcasters. Do you see that?

12 A Can you -- which footnote was this again?

13 Q Footnote 12, the second sentence.

14 A Okay.

15 Q You say, "First, webcasters make more
16 intensive use of musical performances than do radio
17 broadcasters."

18 A Right.

19 Q Have you reviewed Professor Jaffe's
20 rebuttal testimony?

21 A Not in great detail. I've read it, but I
22 -- I don't know what point you're getting to.

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1 Q The point I'm getting to is to ask you the
2 question whether you're aware that he has corrected
3 for that possible criticism in his rebuttal testimony.

4 A That he divided by 15 at some point, is
5 that --

6 Q Correct.

7 A Yes, I recall that.

8 Q And that would scratch this particular
9 analytic itch, I take it?

10 A No.

11 Q The answer is no?

12 A No.

13 Q Reason?

14 A The question is, is -- you know, given
15 that the webcasters are not going -- are not going to
16 incur -- are not going to typically invest in the
17 webcasters and the news broadcasts and the other
18 things, but they're going to rely more primarily on
19 music than any radio station I'm aware of, it may well
20 be that the -- the implied fee per listener hour would
21 be higher in this market. That the value -- the
22 relative value of music to the webcasters would be

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1 higher than to the broadcast radio station. I think
2 that's the point I'm making here.

3 Q That's what you mean by more intensive use
4 of musical performances?

5 A Yes. That the percent of value
6 contributed by the musical performances themselves is
7 greater in the webcasting arena than in the radio
8 broadcasting arena.

9 Q Does that relate to the later portion of
10 your analysis in which you attempt to make an
11 adjustment for that?

12 A I don't know what specific adjust you're
13 talking about.

14 Q Let's move on.

15 A Okay.

16 Q The second part of this footnote --

17 ARBITRATOR VON KANN: Can I just ask on
18 that first one --

19 MR. RICH: Sure.

20 ARBITRATOR VON KANN: -- does that mean,
21 for example, that if a radio station, over-the-air
22 radio station is playing sound recordings, but they've

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1 got this hot-shot DJ, which is also contributing to
2 their revenues --

3 THE WITNESS: Right.

4 ARBITRATOR VON KANN: -- and then on the
5 other hand we have a webcaster that's just playing the
6 sound recordings, no hot-shot DJ --

7 THE WITNESS: Right.

8 ARBITRATOR VON KANN: -- the sound
9 recordings are a bigger factor in generating revenue
10 for the webcaster than they are for the radio station.

11 THE WITNESS: That's correct.

12 ARBITRATOR VON KANN: Okay.

13 BY MR. RICH:

14 Q The second part of this footnote, my
15 question to you -- this is on the issue of how many
16 people may be sitting at a computer at any one
17 moment --

18 A Oh, yes.

19 Q -- do you have any empirical data?

20 A No, I do not.

21 MR. RICH: Mr. Chairman, might we take a
22 two-minute break, and then I'm nearing conclusion.

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1 CHAIRMAN VAN LOON: Yes, let's do so.

2 (Whereupon, the proceeding in the
3 foregoing matter went off the record at
4 12:01 p.m. and went back on the record at
5 12:11 p.m.)

6 CHAIRMAN VAN LOON: Ready any time you
7 are, Mr. Rich.

8 MR. RICH: Thank you. I just need a
9 moment to compose my --

10 CHAIRMAN VAN LOON: Please.

11 MR. RICH: -- thoughts here.

12 CHAIRMAN VAN LOON: Absolutely.

13 ARBITRATOR VON KANN: While you're using
14 that moment, could I ask the witness a question?

15 MR. RICH: Please.

16 ARBITRATOR VON KANN: I think you've said
17 something that I want to make sure I understand, and
18 -- so let me capture it. You tell me if this is
19 correct.

20 A criticism that you have of Professor
21 Jaffe's analysis is that he purports to carry over the
22 radio model of royalties to this field, but in your

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1 view makes a fundamental stake in that, in that the
2 parties -- the radio stations and the performing
3 rights organizations negotiated a royalty based on a
4 percentage of revenue. When you try to convert that
5 to a per performance or per program model, as he did,
6 there are wide variations in the royalties that that
7 generates.

8 And I think you make the further point, I
9 think -- and this is where I want you to make -- that
10 although there are a lot of other factors than the
11 value of sound recordings affecting the revenue of
12 radio stations, and, therefore, arguably a percentage
13 of revenue model is not as good as a per performance
14 model at actually valuing the sound -- the value of
15 the sound recording itself.

16 You're looking perplexed, so I think I
17 should stop there. But I thought in a little dialogue
18 you had with Mr. Rich he made the point that, since a
19 lot of things can influence revenue, DJs and signals
20 and creative programmers and all that other good
21 stuff, a metric based on percent of revenue is a much
22 rougher way of getting at the value of sound

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1 recordings than something that says, "Here's how much
2 you paid per use of our sound recordings, the number
3 of times you use our sound recordings." True?

4 THE WITNESS: What I -- where I have
5 trouble with that view is that it assumes that the
6 performance of music has a value out of context, you
7 know, floating out here somewhere. And it really
8 doesn't. It has value in the context in which it is
9 used. And that's true of -- you know, of a lot of the
10 patents and other things.

11 A reason -- someone may use one patent and
12 pay less, and the other pay more, because the patent's
13 value in the applications differ. And I think all the
14 -- by using a percentage you recognize the fact that
15 the value of music in different applications for
16 different radio stations is different, almost
17 inherently.

18 I mean, for example, a Spanish radio
19 station -- unfortunately, the average income of the
20 Spanish community in the U.S. is below the average.
21 So the revenue that you would expect to get from
22 playing Spanish language music is less than it would

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1 be for playing, say, pop music. And so the value of
2 the music in the context of Spanish radio is less than
3 it is in terms of pop radio.

4 And I think that's consistent with -- it's
5 not that music has some inherent value floating out
6 here independent of its use. It has -- it acquires
7 value through use, and its value really has to do with
8 what percentage of that total value is -- that is
9 created doesn't account for.

10 And I think the negotiations have
11 implicitly -- the negotiations in the radio broadcast
12 arena have implicitly said that the value of music is
13 roughly, you know, the same proportion in these
14 different contexts, but the revenue that actually is
15 achieved is going to differ across contexts.

16 So it is better to -- you know, what the
17 percentage says is revenue contributes a certain
18 percentage of the total value of a radio broadcast,
19 and that's -- that is consistent across formats and
20 types of stations, and so on. But the total revenue
21 that's generated by the process of the broadcast
22 varies substantially across different contexts.

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1 It -- you have to think about it. What's
2 the value of music, you know, in the abstract, out of
3 context? It doesn't have one.

4 CHAIRMAN VAN LOON: Can I ask you whether
5 this is a super-simplified way -- this makes the point
6 -- I'm presuming there's something -- the D.C.
7 Symphony Orchestra. They've got two scheduled
8 concerts Saturday in the Kennedy Center. One is an
9 evening gala where everybody sold seats, and the
10 revenue that's going to come when they play that
11 concert is a million bucks -- \$100,000.

12 Same orchestra, same venue, same day, in
13 the afternoon, they're going to play the same songs,
14 but it's a free concert for firefighters. Okay?
15 You're saying in that context the value of those two
16 performances, even though everything is -- everything
17 is controlled except the audience. And so your
18 argument is that it's really what the audience will
19 pay that determines the value of the performance.

20 ARBITRATOR VON KANN: In a particular
21 application.

22 THE WITNESS: In a particular -- I think

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1 the free versus gala, but if you had a conference for
2 -- that was a performance for families and children in
3 the afternoon where they paid, and there was a
4 performance in the evening for, you know, black tie
5 and free cocktails --

6 ARBITRATOR VON KANN: Same point.

7 THE WITNESS: -- same point. It's just
8 that the -- you know, the value of the music in the
9 context of offering entertainment to families with
10 children is less in terms of dollars than its value in
11 the context of this major gala.

12 CHAIRMAN VAN LOON: And to adapt your
13 analysis, we have to come to that conclusion, that
14 really the value of a performance is -- is 100 percent
15 dependent on essentially the economic revenue that
16 flows as a result?

17 THE WITNESS: The value of a copyright
18 depends on its application. I think that's true
19 across all kinds of copyrights, across all kinds of
20 patents, that the value that is paid depends on the
21 value in the context it's applied. I think that's --

22 ARBITRATOR VON KANN: At least the

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1 economic value of it. We're putting aside the
2 creative value or the --

3 THE WITNESS: The fair market value, the
4 economic value.

5 ARBITRATOR GULIN: Is the natural
6 consequence of your opinions that it really is
7 impossible to construct an economic model to come up
8 with a rate other than simply relying upon agreements
9 that were actually reached in that particular, as you
10 call it, arena?

11 THE WITNESS: I wouldn't use the word
12 "impossible." I'm arguing that the best evidence you
13 have is, in fact, based on the results of such
14 negotiations.

15 ARBITRATOR GULIN: And without those
16 negotiations, do you have an opinion on how to -- what
17 would be the best way to construct a -- without those
18 agreements, what would be the best way to construct a
19 model to come up with a rate?

20 THE WITNESS: Well, I think you'd --
21 absent -- suppose there were -- I mean, are you asking
22 me to suppose there were -- there weren't 26 contracts

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1 signed and we had no information there, what would we
2 do?

3 ARBITRATOR GULIN: Right.

4 THE WITNESS: You would have to look to a
5 benchmark. I mean, that's not an unusual -- I mean,
6 that's what has to be done. You'd want to try to
7 modify the benchmark to reflect differences between
8 the market you were setting the rate in and the -- and
9 the market in which the benchmark was taken from. And
10 it's -- you know, it's a much more complicated
11 process, and the result would not be as good as you
12 would obtain by looking at actual contracts negotiated
13 in the context of webcasting.

14 ARBITRATOR VON KANN: Just one follow up.
15 I'm sorry. I think you have made an additional point,
16 which, frankly, I hadn't -- I'm not sure that I had
17 fully focused on as much until today, which is that we
18 have spent a lot of time in -- our mandate is to try
19 to arrive at rates and terms which, as you know,
20 willing buyers and willing sellers would reach in the
21 marketplace.

22 I think a lot of us -- a lot of the time

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1 has been spent on thinking about that rate in terms of
2 what dollar and cents or what -- what part of a cent
3 per performance or perhaps percentage of revenue it
4 is. That is to say, the -- the actual numeric value
5 of it.

6 I think you have made a point that it
7 becomes important to note whether in the marketplace
8 the participants have opted for a metric based on a
9 percentage of revenue or a metric based on a
10 performance or a metric based on something else, and
11 it isn't a matter of no consequence to just sort of
12 translate one to the other.

13 That is, to the extent we have to
14 replicate what the willing buyers and willing sellers
15 would do if there's very strong evidence that what
16 they do is put it in percentage of revenue, we ought
17 to put it in percentage of revenue. It's not just a
18 matter of saying, "Oh, well, we can quickly convert
19 that to something else and use the same" -- the
20 marketplace is telling us not only something about the
21 numbers, but the marketplace is telling us the vehicle
22 or the device or the metric that it prefers to use.

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1 And what you're saying, if I get it, is
2 that at least in the radio context with performing
3 rights organizations they strongly like the percentage
4 of revenue way of looking at things. And it is of
5 consequence that that's -- that's what they've opted
6 to do, and you can't just say, "Well, we'll convert
7 that to something else and replicate that market."

8 No, no, no. The marketplace has chosen a
9 particular device or model to use. Is that --

10 THE WITNESS: I couldn't have said it
11 better, sir.

12 ARBITRATOR VON KANN: Okay.

13 BY MR. RICH:

14 Q Dr. Schink, following on a couple of
15 questions from the Panel, have you read, as part of
16 your preparation for this proceeding, one of the ASCAP
17 rate court opinions involving the local television
18 industry, the so-called Buffalo Broadcasting decision?

19 A I probably have seen it, but I can't
20 recall as I sit here.

21 Q Let me try to refresh your recollection to
22 see if you -- if this rings a bell. Are you aware

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1 that the central contention -- or a central contention
2 of the local television broadcasting industry, in the
3 period late '80s/early '90s, was that they had been
4 given no option from ASCAP but to accept blanket
5 license fees stated on percentage of revenue terms,
6 does that ring a bell?

7 A I -- yes, that much does.

8 Q And do you recall that it was part of
9 their affirmative rate proposal in the case that the
10 court set flat annual license fees for blanket
11 licenses and thereby sever the relationship of license
12 fee payments to ASCAP from ongoing revenue earnings of
13 the broadcasters?

14 A I don't recall that specific decision.

15 Q Do you recall the outcome in that opinion
16 in that case on that very issue, what the court ruled
17 as to the propriety over the objections of the
18 television industry to continue revenue payments,
19 royalty payments, on a percentage of revenue basis?

20 A I do not remember what the court said.

21 Q So if I represent to you that the court
22 agreed with the broadcasters and severed ongoing

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1 musical works performance payments from percentage of
2 revenue, that's something you're not familiar with
3 sitting here today, is that correct?

4 A That's correct.

5 Q And how familiar are you with the degree
6 of comparability of the historic circumstances of the
7 radio broadcasting industry in respect of the degree
8 of voluntariness of their payments historically to
9 ASCAP and BMI based on percentages of revenue? By
10 "voluntariness" I mean what choices they were given in
11 the negotiations.

12 A I certainly wasn't privy to the
13 negotiations. I don't know to what extent -- I don't
14 know to what extent the alternatives were considered
15 or seriously debated.

16 Q And would you take it as some evidence
17 potentially of relevance to this Panel, per Judge von
18 Kann's ruminations, that in the pending rate
19 proceeding involving the very same radio industry and
20 BMI, they, similarly to the Buffalo Broadcasting local
21 television stations, have asked the court, over BMI's
22 objection, to set license fees in the future not tied

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1 to percentages of their revenue?

2 A I know they requested the court do so.

3 Q And would you find of economic
4 significance in responding to Judge von Kann the
5 possibility that the mere fact that historically the
6 industry agreed to percentage of revenue terms might
7 not reveal the whole story in terms of the
8 desirability of that license form?

9 A It's not so much just desirability that if
10 -- I mean, I'm not arguing that the parties could not
11 have agreed to or might not have -- in the abstract
12 have agreed to a per performance fee. And they may
13 well do so in the future.

14 But we have no such benchmark today. We
15 don't know what that benchmark might be. And I think
16 it's not -- and certainly we have no indication that
17 that benchmark, if it ever arrives, will look anything
18 like the numbers calculated by Professor Jaffe. So --

19 Q Now, on the subject of benchmarks, and
20 following on Judge Gulin, you testified very early on
21 this morning that when you were retained initially by
22 RIAA you were given the assignment to look at various

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1 benchmarks out there, and among those, to your
2 recollection, was the radio broadcasting industry. Do
3 you remember stating that?

4 A Yes.

5 Q Now, what analysis did you make at that
6 time of the pertinence of the radio industry's own fee
7 experience -- well, let me ask the question this way.
8 What music license experience of the radio
9 broadcasting industry did you then examine? Was it
10 the very same experience with ASCAP, BMI, and SESAC?

11 A All we were asked to do was to assemble
12 information on the various things -- the various
13 methods that were used and provide them to RIAA. They
14 wanted -- which they presumably considered in their
15 own deliberations as to how to proceed with the
16 negotiations.

17 Our role in this was, in essence, a
18 provider of information, not a provider of strategic
19 consultant.

20 Q So whose idea was it, the RIAA's or your
21 consulting firm's, to gather data respecting the radio
22 broadcasting industry's music license fee experience

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1 with ASCAP, BMI, and SESAC?

2 A Our assignment was to look at what sorts
3 of arrangements were done across a wide range of
4 areas, and I think we gathered -- we gathered it on a
5 wide range of things, radio broadcasting being one of
6 them, obviously.

7 Q Because that was viewed as potentially
8 relevant, correct?

9 MR. GARRETT: Potentially relevant by who?

10 MR. RICH: I'll break it down.

11 BY MR. RICH:

12 Q Did you find that to be potentially
13 relevant?

14 A We weren't asked to offer that opinion
15 particularly. We were asked to assemble the
16 information on what was being charged.

17 Q Is it reasonable to assume that you were
18 not asked to pursue a project that was viewed as
19 irrelevant by your client?

20 A No. I'm sure they thought it was
21 relevant, but I don't know whether or not they -- how
22 -- what weight they gave to any particular set of

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1 numbers we gave them.

2 Q Now, just a cleanup question or two on
3 Arbitron. If a radio listener drives to work and
4 listens to a consecutive hour of a given station, how
5 much time would Arbitron calculate as the listening
6 time in that situation?

7 A I can't tell you. I would assume an hour,
8 but I may be wrong.

9 Q Four average quarter-hours, I assume, or
10 one hour.

11 A That would be -- but I don't know. That
12 would seem logical, but I --

13 Q So under your own formulation, where you
14 take an average of 10 minutes, how much time would be
15 assigned to that one hour of listenership?

16 A Forty minutes.

17 Q Turning back to footnote 12 of your
18 testimony, please. Back to the first section where
19 you interpreted the sentence, "First, webcasters make
20 more intensive use to be something other than a simple
21 measure of actual uses of songs per hour." Yes?

22 A Right.

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1 Q By the way, is the following sentence
2 beginning with, "Professor Jaffe determined that radio
3 stations, on average, play 11.2 songs per hour.
4 Michael Wise indicated that" -- you say indicted that,
5 but I think you meant indicated -- "that on average
6 over Net Radio's hundred channels 15 songs were played
7 per hour"?

8 MR. GARRETT: Excuse me. I think that was
9 something that he had given in restricted session.
10 We're in open session now.

11 MR. RICH: I'm happy to blank out the
12 numbers for purposes of my question. We're on
13 footnote 12, page 9. Would it help, Mr. Garrett, if
14 we struck that question and --

15 MR. GARRETT: It's not that it helps me.
16 It was your witness, and I thought that since he had
17 given it during restricted session that --

18 MR. STEINTHAL: I would just reframe the
19 question.

20 MR. RICH: Let me reframe the question.

21 BY MR. RICH:

22 Q Is the second -- I won't read it into the

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1 record. Is the Professor Jaffe sentence intended to
2 be explicatory of the prior sentence, or an
3 independent thought?

4 A It is intended to sort of say that
5 webcasters make more intensive use of music than do
6 radio stations.

7 Q Measured by songs per hour, yes?

8 A Yes, the time devoted to music is greater.

9 Q Yes. And to what degree does the general
10 criticism you level in those first sentences apply to
11 the simulcasting industry?

12 A Do you mean to the industry that --

13 Q To the practice of simulcasting, the
14 delivery over a webcasting stream of the same over-
15 the-air broadcast signal by a simulcaster.

16 A It wouldn't apply to that, because it
17 would be the same number.

18 Q The issue of relative music intensity
19 would not be a factor in that setting, is that right?

20 A Right. You'd have to be a pure streamer
21 I think for this. This applies to somebody who
22 essentially was a pure streamer.

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1 Q Now, turning to -- briefly to Section
2 Roman IV of your analysis, which I know Mr. Joseph
3 will be inquiring more as to, I'd like you to turn to
4 paragraph 22 of that testimony. You might also want
5 to have handy page 6 of your demonstrative.

6 Am I correct, sir, that paragraph 22
7 captures the gist of your reasoning on this point when
8 you state that, "The appropriate revenue of webcaster
9 license fees for musical works and sound recordings
10 should reflect the relative values of the
11 contributions of the songwriters (publishers) and the
12 record companies to producing the sound recording and
13 to delivering the sound recording performance for the
14 webcasters.

15 "he relative costs of these contributions,
16 and the relative income earned by the two parties for
17 these contributions are appropriate proxies for the
18 relative values." Is that a -- that -- it seems to me
19 to be a synopsis of the reasoning you engage in, is
20 that fair?

21 A That's fair.

22 Q And does page 6 of your demonstrative

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1 basically capture the same thought?

2 A Yes.

3 Q Now, if you stay with the demonstrative,
4 and if we were to substitute for the word "webcasters"
5 another group of licensees -- let's just stick in
6 "movie studios" -- would that statement still apply
7 with full force as a matter of economic theory?

8 A As a matter of economic theory, yes.

9 Q And would your thesis also apply as a
10 matter of economic theory whether we are talking about
11 obtaining performing rights from, respectively, music
12 publishers and record companies versus, let us say,
13 recording rights for purposes of incorporation into a
14 motion picture film, the same principles would apply
15 I take it?

16 A The same approach would apply. I mean,
17 there are differences in the markets and differences
18 -- differences in the markets can certainly lead to
19 different results.

20 Q But you would still expect, I take it, if
21 your theory were valid that the relative license fees
22 payable -- let me be concrete. If a particular

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1 rendition of a musical work embodied in a sound
2 recording were licensed by a movie studio for use in
3 a motion picture film, do you have an understanding as
4 to the respective rights that studio is required to
5 obtain in order to utilize both the musical work and
6 the sound recording?

7 A Yes. They have to obtain a sync right
8 from the music publishers and a master use right from
9 the record company to use a prerecorded -- prerecorded
10 music.

11 Q And per your theory, would it then be the
12 case that the relative fees that ought to be observed
13 in the licensing of the master use and synchronization
14 rights should "reflect the values of their relative
15 contributions," meaning the record companies and the
16 music publishers, "to producing and delivering a sound
17 recording"?

18 A Well, the relative compensation, including
19 any sort of promotional benefits, and so forth, should
20 reflect the -- the total compensation --

21 Q The total compensation, yes.

22 A -- should reflect it.

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1 Q And I take it from the remainder of your
2 analysis in Roman IV that taking account of those
3 factors we should see a ratio in terms of total
4 compensation of a range of four to six times payable
5 for the master use fee to that payable for the
6 synchronization fee. Is that correct?

7 A No, you'd have to take into account the
8 total -- the total compensation. The compensation can
9 be in forms other than the fee.

10 Q But taking the total compensation at the
11 end of the day, however measured, would result in a
12 ratio of four to six times the compensation, however
13 measured, for the master use fee as compared to the
14 sync fee?

15 A Assuming you can argue you have a
16 competitive marketplace, assuming you can have --
17 assume that nobody has market power, the total
18 compensation should reflect the total -- the value of
19 the contributions, yes.

20 Q And do you regard the market in which
21 master use and synchronization rights are licensed to
22 motion picture studios as a competitive market in the

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1 licensing of those?

2 A I think the -- you have certain problems
3 with that. I think the -- I think there's a -- it's
4 a complicated issue. I think that there are -- there
5 are arguments to suggest that the compensation that
6 the record companies obtain as a result of -- of
7 giving master use rights to the -- to the movie --
8 movie producers, companies, whatever you call them, is
9 probably substantially greater than that that were
10 received by the music publishers.

11 And I think the other possibility -- the
12 other thing is that the movie producers have
13 substantial leverage vis-a-vis the record companies
14 that they don't have against the music publishers.
15 The --

16 Q And what's the basis for that statement?

17 MR. GARRETT: He hadn't finished his
18 answer.

19 MR. RICH: Sorry.

20 THE WITNESS: If a producer of a movie
21 wants to use a particular musical work in his movie,
22 whether he uses a prerecorded music or he gets the

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1 studio band to record it, the music publishers get
2 their sync right. It doesn't matter how it got there,
3 they get paid that.

4 However, if the -- if a particular musical
5 work is going to be used, the movie people -- these
6 are negotiations not between -- with the RIAA. These
7 are negotiations in the individual record companies
8 and the movie houses, with the possibility that the
9 same sound recording may have been recorded by
10 different record companies.

11 So you can play off one company's
12 recording against the other, or you can simply say, if
13 you don't give me a better deal than that, I'm not
14 going to use your recording in my movie. I'm going to
15 have my studio band record it, and you'll get nothing.

16 So I think you have a situation here
17 where, given the promotional benefits that a record
18 company might receive for this, that they, in fact, by
19 -- by using music in a movie, it may, in fact, spur a
20 -- you know, a follow-on increase in record sales,
21 that there is the option or possibility by letting the
22 movie use your music the record companies could get

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1 the right to distribute the movie soundtrack, they
2 could get the right -- quite often, if there's a fair
3 amount of popular music used in the movie, there's a
4 compilation of songs used in the movie, they get the
5 right to distribute that.

6 So I think in these negotiations all of
7 these factors have to take into account. By looking
8 simply at the fees you aren't going to see all of
9 this.

10 BY MR. RICH:

11 Q Other than conversation with counsel for
12 the RIAA, from whom have you derived these sets of
13 understandings?

14 MR. GARRETT: I object to that
15 characterization.

16 MR. RICH: It's a perfectly appropriate
17 question. I'm not asking for conversations with
18 counsel, such as he may have had.

19 BY MR. RICH:

20 Q I'm saying excluding any such
21 conversations, what's the basis of your knowledge?

22 A Basically, I've -- I am aware, at least,

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1 you know, in the work I've done for RIAA in the past,
2 some reading I've done, of how this is done. I mean,
3 how the fact that there are sync rights and master use
4 rights and how they're negotiated -- I mean, that's my
5 knowledge.

6 And I, you know, thought about what
7 Professor Jaffe said, obviously, after reading his --
8 you know, his rebuttal testimony, and thought, well,
9 you know -- tried to think through whether he was
10 right or not, and I -- I concluded that I don't think
11 he necessarily is.

12 Q You've testified fairly specifically as to
13 the hypothetical dynamics of a given negotiation where
14 a particular musical work is desired. What's your
15 understanding of the frequency that that need for a
16 particularized musical work occurs in -- in
17 transactions involving the licensing of sync and
18 master use rights?

19 A How often these transactions take place?

20 Q Yes, in which there is a need for an
21 absolute singular need for a particular musical work.

22 A I don't know. My understanding is that

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1 the people who are producing a movie have people who
2 are selecting or designing the soundtrack for the
3 movie, and they pick certain -- they're looking for a
4 certain effect, and they will -- if they find an
5 effect they like, that fits with the mood of the
6 movie, they will select it.

7 And if there's something prerecorded that
8 fits, they may use that. They will probably evaluate
9 it -- the prerecorded options versus either of their
10 own playing of that music, or they can commission
11 someone to write music to fill whatever need they're
12 trying to accomplish.

13 Q How many conversations have you had with
14 any of those creative people?

15 A None specifically.

16 Q And relative to your situation where you
17 say there might be an identifiable musical work that
18 the studio must have, how often is it your
19 understanding that there is a particular performer who
20 the studio must have -- say, "We need Streisand, and
21 I don't care what she sings, the mood of this piece
22 needs a Streisand piece." Relative to needing a

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1 particular musical work, how often is it your
2 understanding, from whatever source, that that occurs?

3 A My understanding that both occur. We've
4 picked a piece of music, we've picked an artist. But
5 there also I think are, as I understand it, a number
6 of cases where they're not thinking in terms of
7 particular music but mood. They're looking for an
8 effect which doesn't -- which can be filled by a work
9 or an artist, but also it might be filled otherwise.

10 Q And so in that situation the leverage, if
11 you will, is with the record company, is that right?

12 A What situation?

13 Q In a situation, let us say, where a
14 particular artist is desired and that artist contracts
15 with one of the labels. I take it in that negotiation
16 the power lies with the labels relatively speaking,
17 correct?

18 A If you want to use a particular piece of
19 recorded music, I'm not aware that the artist could
20 contract to perform with the studio band to do the
21 same thing, but I -- I may be wrong on that.

22 Q And, again, the source of your knowledge

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1 on all of this is just some -- a little bit of reading
2 you've done now and again?

3 A My source of knowledge is my reading, yes.

4 Q And you talked about the large promotional
5 value you understand inures to the record labels.
6 Tell me a little more about your understanding about
7 that, in the setting of master use licensing.

8 A My understanding is that --

9 ARBITRATOR VON KANN: Can I ask a
10 question, so I can follow? Where in Dr. Schink's
11 testimony does he deal with this sync master work --

12 MR. GARRETT: He doesn't deal with it in
13 his testimony. This is Mr. Rich's cross examination
14 asking him how his theory squares with the study they
15 dumped in at the last minute.

16 CHAIRMAN VAN LOON: It came off of
17 paragraph 22 and demonstrative 6. So it was the take
18 off from the --

19 MR. RICH: It's a direct test of his
20 theory against the empirical data.

21 MR. GARRETT: Okay.

22 MR. RICH: I didn't hear an objection from

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1 counsel.

2 BY MR. RICH:

3 Q Sir, do you have the question?

4 A No, I've lost it, I'm afraid.

5 Q The question is, you gave some generalized
6 testimony about the assertedly large promotional value
7 enjoyed by record labels associated with master use
8 licenses, and I want you to tell me all you know about
9 that subject.

10 A Well, the --

11 MR. GARRETT: Wait, wait a second. All he
12 knows about that subject?

13 MR. RICH: About that subject, yes.

14 ARBITRATOR GULIN: That's not a relevant
15 question.

16 BY MR. RICH:

17 Q Can you tell me the basis for that
18 statement, please?

19 MR. GARRETT: I'm sorry. Which statement
20 are we referring to now?

21 MR. RICH: The suggestion that there is
22 large promotional benefits above and beyond the actual

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1 dollar consideration paid for the master use fee that
2 inures to the benefit of the record label.

3 THE WITNESS: My -- I hope I -- if I
4 didn't use the word "potentially," I should insert it
5 now. They are potentially large. I don't have the
6 proof that they are large.

7 That the -- again, it's my understanding
8 of -- of the process and how it works. I mean, the --
9 people don't view, you know, going to a movie or
10 renting a video as a substitute to buying a record,
11 that I'm aware of. So the use of the song in the
12 movie in no way is going to cannibalize the other
13 revenues that the recording industry might obtain.

14 However, the exposure of the song --
15 sometimes they are current popular songs, sometimes
16 they are songs that have sort of come and gone in
17 terms of their sales. The use of these in a movie may
18 well, in fact, spur additional sales, revive an album
19 that had sort of passed its prime because people hear
20 it in the movie and it becomes current again.

21 So the use in a movie can spur additional
22 -- additional record sales without, I think, any --

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1 you know, any logical way in which it could have a
2 negative effect of costing them sales or substituting
3 for sales.

4 And then, you know, I'm aware also that
5 the record companies in fact find it profitable to
6 distribute songs -- you know, the soundtracks and the
7 compilation of music that's used in movies.

8 And to the extent that they strike a deal
9 with a movie to use some of its recorded movie --
10 movie as a quid pro quo, either part of the contract
11 or just an understanding between the parties who are
12 going to get the right to then distribute the -- or
13 are going to be considered for the right of
14 distributing the soundtrack or the compilation album,
15 that would -- that would be an additional sort of, you
16 know, compensation or potential compensation to them.

17 So that's -- that's the other benefits I
18 was thinking about.

19 BY MR. RICH:

20 Q Have you seen any empirical data
21 supporting the level or degree of -- or amount of
22 promotional value stimulated by the use of a sound

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1 recording in a motion picture soundtrack?

2 A No, I have no empirical data.

3 Q And I take it as to your last observation,
4 namely the possible spurring of sound -- of a
5 soundtrack album -- that to the extent one observes
6 transactions not involving the development of a
7 soundtrack album, that would be an area that would not
8 be one from which the label would be deriving further
9 revenues, correct, by definition?

10 MR. GARRETT: From any source, or the
11 revenues from --

12 MR. RICH: Let me rephrase.

13 MR. GARRETT: -- contracts?

14 BY MR. RICH:

15 Q I believe I understood you to say that
16 another source of value, if you will, to the record
17 label would be a circumstance where the use of the
18 recording in the motion picture film would generate
19 soundtrack album sales, correct?

20 A Yes, it's one of the -- it's one of the
21 things that makes it attractive for a record company
22 to allow a movie to use its recorded music.

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1 Q Yes. And we know that that does not occur
2 in every such transaction, is that correct? That not
3 every movie stimulates such a soundtrack album,
4 correct?

5 A That would not -- not everybody who gives
6 the right gets the right to distribute the album.
7 That would be correct.

8 Q And have you also given consideration on
9 the other side of the ledger to promotional value to
10 the music publishing company of the incorporation of
11 the musical work in the soundtrack of a motion picture
12 film?

13 A I think the -- their benefit is the same
14 whether or not, you know, the particular album gets
15 used or not. If they use a studio band to record the
16 music, the record company gets nothing, and the
17 performing -- you know, the performance rights people,
18 the publishers, get their sync right fee in any case.
19 So --

20 Q My question was I think slightly
21 different, and maybe not clear, which is, can you
22 identify other potential promotional benefits to the

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1 music publishing company associated with the
2 incorporation of the musical work in a movie
3 soundtrack?

4 A Well, to the extent there were more sales,
5 they'd get their mechanical rights payments. There
6 may be more radio play. So there are some also.

7 Q Yes. And have you attempted to balance
8 the relative promotional benefits to the record label
9 on the one side and the music publishing company on
10 the other associated with the licensing of a given
11 musical work embodied in a given sound recording?

12 A Since I have --

13 MR. GARRETT: I'm sorry. Just --
14 licensing in the context of a motion picture or in the
15 context of --

16 MR. RICH: Of a motion picture.

17 MR. GARRETT: -- the entire market?

18 MR. RICH: Of a motion picture.

19 THE WITNESS: I haven't -- I have data on
20 -- I do not have data on the dollar amounts of the
21 benefits on either side of the ledger.

22 MR. RICH: May I have a moment, please?

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1 I have no further questions.

2 CHAIRMAN VAN LOON: Mr. Joseph, what is
3 your estimate of --

4 MR. JOSEPH: My estimate is an hour with
5 the hopes that I will be a pleasant surprise rather
6 than an unpleasant surprise. But I certainly am not
7 sure. So I would estimate an hour and endeavor to be
8 less.

9 CHAIRMAN VAN LOON: Well, it certainly
10 makes it clear we're not going to wait until you're
11 finished to have lunch.

12 (Laughter.)

13 MR. JOSEPH: I expected that would be the
14 outcome.

15 CHAIRMAN VAN LOON: Okay. Why don't we
16 adjourn, then, until 10 minutes 'til 2:00.

17 Dr. Schink, because you're in the midst of
18 the process of cross examination, we have a rule that
19 you cannot consult with your counsel during this time,
20 during this break, about your testimony.

21 THE WITNESS: I understand that.

22 CHAIRMAN VAN LOON: Okay. Thank you.

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1 MR. GARRETT: Mr. Chairman, if I had our
2 next witness here at about quarter to 3:00, would that
3 be about right or --

4 CHAIRMAN VAN LOON: I think that that
5 sounds right, assuming that Mr. Rich's -- I'm sorry,
6 Mr. Joseph's estimate is correct, and that you have
7 little planned in the way of redirect.

8 MR. GARRETT: Okay. Thank you.

9 (Whereupon, from 12:51 p.m. until 1:59
10 p.m., the proceedings in the foregoing matter went off
11 the record for a lunch break.)

12 CHAIRMAN VAN LOON: Yes, Mr. Garrett.

13 MR. GARRETT: Mr. Chairman, I have the
14 executed affidavits that we've been discussing.

15 CHAIRMAN VAN LOON: Excellent.

16 MR. GARRETT: Do you want us to file the
17 original with the Copyright Office?

18 CHAIRMAN VAN LOON: Yes, please.

19 I do know that today they're closed, still
20 again, and probably will be tomorrow. So, we've
21 alerted them that we're breaching protocol by
22 accepting things in order to keep things moving

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1 forward.

2 Ms. Leary, I just wanted to check -- you
3 were closing the door. Are you expecting to be here
4 this afternoon --

5 MS. LEARY: Yes.

6 CHAIRMAN VAN LOON: -- during Mr. Marks?

7 MS. LEARY: Yes.

8 CHAIRMAN VAN LOON: Mr. Joseph,
9 unfortunately, your cross-examination is starting
10 almost at the stroke of the hour, so people will have
11 a bright-line test of how long it goes. But, the
12 floor is completely yours.

13 (Laughter.)

14 MR. JOSEPH: Thank you, Mr. Chairman. Dr.
15 Schink, My name is Bruce Joseph -- another Bruce, but
16 you don't have to worry about either the "Mr." or the
17 "Esquire".

18 (Laughter.)

19 CROSS-EXAMINATION

20 BY MR. JOSEPH:

21 Q I'd ask you to turn to paragraph 45 of
22 your written testimony.

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1 A (Witness complies.)

2 Q Now, do you see toward the middle of --
3 well, it's actually a long paragraph -- but toward the
4 middle, where you say, "Radio play almost certainly
5 serves to significantly increase the music publisher's
6 income from television, including cable of satellite,
7 from live and recorded performances for the use of
8 music." Do you see that?

9 A Yes.

10 Q Did you rely on any data or conduct any
11 study to support your statement that this almost
12 certainly occurs?

13 A I -- no, I did not have any data to
14 support this.

15 Q Okay. Now, did you -- I take it, then,
16 you didn't rely on any data or conduct any study to
17 determine the amount of any such effect that almost
18 certainly occurs, either, did you?

19 A No, I did not.

20 Q Now, if you look a couple of lines down --
21 in my copy, it's actually on the next page, but I
22 don't know that all the copies are the same -- where

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1 you say, "If this radio play were to be responsible
2 for 27 percent of the other income of music
3 publishers," I take it you didn't rely on any data or
4 conduct any survey to determine whether, in fact,
5 radio play is responsible for 27 percent of the other
6 income of music publishers, is that correct?

7 A That's correct. It should be viewed as a
8 hypothetical.

9 Q Now, let me just take you back to a little
10 bit of your testimony this morning, where you were
11 describing -- I think what you were talking about is
12 basic intermediate microeconomics, where you said
13 that, "The addition of sound recording performance
14 revenue will call forth new production, so more sound
15 recordings will be produced." Do you remember that
16 testimony, generally?

17 A Yes, I do.

18 Q Okay. Now, in that testimony, you
19 referred to a profit maximizing level of sound
20 recording production. Do you remember that?

21 A That's correct.

22 Q Okay. Hypothetically, just so we can have

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1 a concrete number in mind, let's say that, before any
2 new revenue stream, the profit maximizing is 10,000
3 sound recordings a year. Can we agree on that number,
4 just hypothetically?

5 A Hypothetically, yes.

6 Q Okay. Now, by "profit maximizing level",
7 I take it that means if the number of sound recordings
8 produced were actually increased by, say, a hundred
9 sound recordings, the record industry would actually
10 make less money, less profits. That wouldn't maximize
11 it, correct?

12 A If you -- if 10,000 were the profit-
13 maximizing level, then any more, any less, produces
14 less profit.

15 Q Okay. Now, again, just for the purpose of
16 the hypothetical, let's say I write a check for \$10
17 million to the record industry that is wholly
18 unrelated to the number of sound recordings produced.
19 You would agree, would you not, that the profit-
20 maximizing level for the production of sound
21 recordings would still be 10,000 a year, is that
22 correct?

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1 A You gave them a gift of \$10 million,
2 essentially?

3 Q We can call it any kind of revenue stream
4 that is wholly unrelated to the number of sound
5 recordings produced, to the level of production.

6 A I guess, if -- I mean, if the record
7 industry -- it's hard to deal with it. I mean, if the
8 record industry, in fact -- you know, if it was an
9 outright gift, for no reason whatsoever, I can agree
10 with you. Beyond that, I think it's difficult to
11 answer the question.

12 ARBITRATOR VON KANN: Is this profit-
13 maximizing number the number at which the gross margin
14 is the best? Or, in absolute dollars, it generates
15 the most profit?

16 THE WITNESS: It -- it's the most profit
17 dollars in total.

18 ARBITRATOR VON KANN: Okay.

19 BY MR. JOSEPH:

20 Q Well, if the gift were \$20 million a year,
21 it wouldn't change your answer, would it?

22 A An outright gift for no reason -- I don't

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1 see why.

2 Q Why it would change your answer?

3 A Why it would change my answer.

4 Q Let's turn back to paragraph 22 in your
5 testimony, where I believe you were speaking with Mr.
6 Rich earlier, as the morning session was closing,
7 which I think you agreed contained the basic point of
8 your analysis in point 4.

9 And that is, "The appropriate fees for
10 sound recording performance rights, as compared to
11 musical work performance rights, should reflect the
12 relative value of the contributions of songwriters and
13 publishers on the one hand, and of record companies
14 and artists on the other hand, in the production of
15 sound recording, and in delivering the sound recording
16 performance to the webcasters." Is that what you say
17 there?

18 A Yes.

19 Q Okay. Now, again, in paragraph 23, you
20 speak of reflecting the relative cost or income earned
21 for the contributions to producing a sound recording,
22 correct?

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1 A Twenty-three?

2 Q Paragraph 23; the very first sentence of
3 paragraph 23.

4 A Yes. I see that.

5 Q And again, in paragraph 24, you purport to
6 calculate license fees in a manner that "reflects the
7 value of their relative contributions to producing a
8 sound recording," correct?

9 A Correct.

10 Q Now, I notice that between paragraph 22
11 and 24, the concept of delivering the sound recording
12 performances to the webcasters has fallen out. Is it
13 correct that that's explained in paragraph 13 -- I'm
14 sorry, in footnote, where you assume that the cost of
15 that is relatively small and can be assumed to be
16 zero?

17 A That's correct.

18 Q Now, let's make sure we're all speaking
19 the same language here. In all of those paragraphs,
20 you refer to something called a "sound recording",
21 correct?

22 A Correct.

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1 Q Are you aware that "sound recording" is a
2 term defined in the Copyright Act to mean the
3 copyrighted work, as opposed to a physical CD, for
4 example?

5 A I wasn't aware of that specific
6 definition, no.

7 Q When you used the term "sound recording",
8 were you using it to refer to the intellectual
9 property that is, in effect, the work that results
10 from the fixation of a series of musical, spoken or
11 other sounds? Or, did you mean it to mean something
12 else?

13 A I meant it to mean the process of creating
14 a recorded work, or recorded music.

15 Q No. I'm not asking you about the process;
16 I'm asking you about what you meant by the term "sound
17 recording", which is what you're purporting to value
18 here.

19 A It's the value of the sound recording to
20 the -- you know, in the -- you know, in whatever
21 process we're doing. And so, I think I'm using it in
22 terms you're saying, but I'm having a hard time just

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1 getting the nuance of your distinctions here.

2 Q Well, I'm asking -- you're the one who
3 used the term several times. And I'm asking you what
4 you mean to refer to when you say "sound recording" in
5 your testimony.

6 A I was thinking of it more in a process
7 sense. But I think, in terms of the copyright, it is
8 the use. You know, it's basically the -- well, I have
9 a hard time distinguishing between the two, I guess.

10 Intellectually, I was thinking of it in
11 terms of the process.

12 Q Well, so is it your understanding here
13 that the Panel here is supposed to develop a value for
14 a process or a value for the performance of a certain
15 type of intellectual property?

16 A Value for the performance.

17 Q Of a certain type of intellectual
18 property, is that correct?

19 A Yes. Right.

20 CHAIRMAN VAN LOON: I didn't hear that
21 answer.

22 THE WITNESS: Yes. That's correct.

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1 BY MR. JOSEPH:

2 Q Would it be worthwhile if we showed you
3 the Copyright Act definition of "sound recording", and
4 you can tell us whether it's consistent with the
5 meaning that you utilized in your analysis and in your
6 testimony?

7 A It would help to read it, if you want me
8 to.

9 Q Okay. Why don't we let the witness see
10 the definition.

11 (Brief pause.)

12 BY MR. JOSEPH:

13 Q If you look, Dr. Schink, at the second
14 definition on page 5, is that consistent with how you
15 were using the term "sound recording"?

16 A I mean, I guess, in some sense, I've used
17 it in this sense. But I've also -- I think, in a way,
18 I've used it in a text that -- so that it would be the
19 process of creating same.

20 But, I would understand that this is what
21 the copyright would be -- would be paid for.

22 Q So, if the process of creating the

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1 copyrighted work that is the sound recording, as
2 opposed to the "material objects, such as disks, tapes
3 or other phono records in which they are embodied,"
4 correct?

5 A I think it's regardless of how they're
6 embodied, is what it says, as I read it.

7 Q No. I understand, that's what it says.
8 I'm asking you whether, when you were using the term
9 "sound recording", you were using it to refer to the
10 copyrighted work or the process of creating the
11 copyrighted work, as opposed to material objects, such
12 as disks, tapes or other phono records in which they
13 are embodied.

14 A I think I was referring to the process of
15 creating a work.

16 Q The work?

17 A The work. The recorded work.

18 Q So that -- would you say your analysis is
19 attempting to value the relative contributions to the
20 creation of the copyrighted work -- I'm sorry. I'll
21 withdraw that question.

22 I think it would probably be better to ask

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1 whether -- would you say that what you're trying to
2 compare, bottom line, is the relative value of the
3 contribution of the record companies, on the one hand,
4 when they contribute the sounds to the sound
5 recording, and the contribution of the songwriters and
6 the publishers, on the other hand, when they
7 contribute the musical works to the sound recordings.
8 Are they the contributions you're trying to get a
9 relative value for?

10 A In -- if you look to the -- one of the
11 measures, the so-called "direct measure", I limit
12 myself just to that. When I go to the total measure,
13 I'm looking at all costs, including the cost of
14 producing the physical sound recording, as well as all
15 the costs incurred by the publisher.

16 So, in one instance, I limit it just to
17 the cost leading up to and prior to the production of
18 the CD and the sound recorder -- and the physical CDs
19 and their distribution.

20 In the other case, I include them all, but
21 I'm equally expansive on both sides of the ledger. I
22 include all the costs of the record companies and all

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1 the costs of the publishers.

2 Q I'm sorry, Dr. Schink. Maybe my question
3 wasn't clear. I wasn't asking what methodologies you
4 employed to get to this result; we'll discuss those in
5 a moment.

6 What I was asking was, in regard to what
7 you describe as the purpose of your analysis in
8 paragraph 22, 23 and 24, the underlying goal, the
9 relative values you are trying to establish -- what
10 I'm asking is whether the bottom line is that you're
11 trying to value the relative value of the
12 contributions of the record companies and artists, on
13 the one hand, when they contribute the sounds to the
14 sound recording, and the contributions of the
15 songwriters and the publishers, on the other hand,
16 when they contribute the musical works to the sound
17 recording?

18 A I think that's fair. Yes.

19 Q Now, for your analysis, you use 1997 data
20 from the record companies. Is that because that was
21 the most recent data you had?

22 A That's correct.

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1 Q Were the record companies unwilling to
2 provide you with more recent data?

3 A There's simply, when I got involved, not
4 the time to do this -- to go beyond what Linda
5 McLaughlin had already done.

6 Q And, I'm sorry -- when did you get
7 involved again? You may have testified to that
8 already.

9 A About a month before I submitted my
10 testimony.

11 Q And that was when you got involved, was
12 actually this rebuttal testimony?

13 A Correct.

14 Q Did you talk to any of the record
15 companies or the music publishers, to understand the
16 data you used in the analysis that appears in this
17 Part 4?

18 A I talked to -- I read Linda McLaughlin's
19 testimony and taught her to go over what was in the --
20 what she had measured, to make sure I understood it.

21 Q And did you talk to anybody from any of
22 the record companies or the music publishers directly?

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1 A No, I did not.

2 Q Do you know whether Ms. McLaughlin spoke
3 to anyone from any of the record companies or the
4 music publishers in connection with your rebuttal
5 testimony, as opposed to what she may have done
6 before?

7 A Not to my knowledge.

8 Q Now, did you rely on any facts conveyed in
9 the conversation with Ms. McLaughlin, or was it just
10 to get a general understanding of what she had?

11 A Well, after reading her testimony, we
12 talked to confirm my understanding of what was there,
13 and also to establish the share of the labels in the
14 total industry being 72 percent.

15 Q Did you -- in your study a little later on
16 and -- during your direct testimony, you cited a study
17 by the National Music Publishers Association for
18 information about revenue in the publishing industry,
19 correct?

20 A That's correct.

21 Q Did you talk to anyone about the NMPA
22 study?

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1 A No, I did not.

2 Q Going back to the record companies and the
3 music publishers who provided data, did counsel convey
4 any facts about the record companies or the music
5 publishers that you used in your analysis?

6 A Not that I can think of.

7 Q Okay. Okay, so now let's talk about your
8 cost of production method, and how you analyzed the
9 cost of producing this intellectual property called a
10 sound recording.

11 Probably, the best way to do it -- I don't
12 know that we need to get the projector, if everyone
13 had the slide series -- is to turn to, I think, slide
14 nine. That's the first place -- well, it's not the
15 first place. But, let's turn to slide nine.

16 Now, you say that --

17 MR. JOSEPH: -- we probably ought to go on
18 the restricted record.

19 CHAIRMAN VAN LOON: Okay. Let the
20 transcript so reflect.

21 (Whereupon, at 2:17 p.m., the proceedings
22 went into Closed Session.)

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1 CHAIRMAN VAN LOON: Mr. Marks, we want to
2 welcome you back. We can promise a couple of things,
3 at least one of which is that you will not be on the
4 stand this time as long as last time. The Panel will
5 make sure of that. You have a secondary purpose of
6 why you're here, which is to keep us away from the
7 brownies and chocolate cookies that are outside, so we
8 want to go straight through, no breaks.

9 THE WITNESS: Okay.

10 CHAIRMAN VAN LOON: But welcome back.

11 THE WITNESS: Thanks.

12 CHAIRMAN VAN LOON: And let me ask you to
13 raise your hand and be sworn. Mr. Katz, I believe you
14 have a few things on direct.

15 MR. KATZ: I've reached the point in my
16 career when I rarely find myself doing things I've
17 never done before, but I've never put on as a witness
18 a lawyer with whom I've tried cases before.

19 WHEREUPON,

20 STEVE MARKS

21 was recalled as a Witness by Counsel for the RIAA,
22 having already been duly sworn, assumed the witness

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1 stand, was examined and testified as follows:

2 DIRECT EXAMINATION

3 BY MR. KATZ:

4 Q Mr. Marks, one of the things that you've
5 been designated to speak about were Mr. Gertz'
6 proposals regarding the designation of his
7 organization as an agent for receipt of royalties.
8 What thoughts do you have about Mr. Gertz' appointment
9 in that regard?

10 A Well, we don't oppose Mr. Gertz'
11 organization being designated as an authorized agent.
12 I think we would oppose his organization being
13 designated as the agent for all of our non-members.
14 I think that our feeling is that the Panel could
15 essentially designate both of us as, quote,
16 "authorized agents," and then copyright owners could
17 choose which organization they wanted to collect and
18 distribute the royalties for them. And that the
19 Copyright Office could, in the notice and
20 recordkeeping proceeding, implement the appropriate
21 procedures to have copyright owners designate -- those
22 that are not already members of either organization

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1 designate which of the two they want to then collect
2 and distribute the royalties for their performances.

3 Q Do you have a thought as to how it would
4 work from the webcasters' standpoint if there was more
5 than one authorized agent for receipt of royalties?

6 A I haven't done a lot of thinking about it,
7 but I think one way it might work is that the
8 webcaster would send performance logs to each, and
9 each designated agent, each entity, would analyze the
10 logs and then invoice the webcaster based on the
11 performances that were made by the webcaster of that
12 agent's or that entity's members.

13 Q One of the thoughts expressed by Mr. Gertz
14 would be that he would receive some payment from the
15 royalties to the extent he was going to be designated
16 as an agent for webcasters to pass their payments
17 along to Sound Exchange. Do you have any views as to
18 the appropriateness of that?

19 A Well, I think that's a very different role
20 than being the collection and distribution agent for
21 the copyright owners. That's a different service that
22 Mr. Gertz might offer to webcasters. I think that

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1 that service is something that should be -- it's a
2 service to the webcasters, and the webcasters should
3 pay for it. It wouldn't be appropriate for whatever
4 fees were paid to come off of the royalties that are
5 otherwise payable. I think that the regulations, as
6 they exist for preexisting subscription services and
7 what we think is appropriate for this proceeding, is
8 that whatever royalties are payable would be payable
9 to the designated agent for those copyright owners,
10 and they would be payable in full, not with some
11 deduction for a service like that that might be
12 performed by a third party.

13 Q Mr. Marks --

14 CHAIRMAN VAN LOON: Can you just clarify
15 again exactly which service you're speaking of?

16 THE WITNESS: Sure. I think that -- yes,
17 we should distinguish between a collecting and
18 distributing agent for copyright owners in collecting
19 the royalties and then distributing it, and an entity
20 providing, as a third party, a service to the users,
21 or in this case the webcasters, to put together
22 reports and then send those reports to the designated

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1 agents. I think that -- I guess Mr. Gertz has
2 proposed to maybe do both of those things -- collect
3 and distribute for copyright owners but also to
4 provide the service to webcasters. I think that there
5 are appropriate costs that are associated with the
6 collection and the distribution function for the
7 copyright owners that are properly deducted.

8 I question, frankly, whether a profit is
9 part of that, because I'm not aware of any collecting
10 agency in the world that takes -- that acts as a for-
11 profit entity. But that is a very different role than
12 providing a service, as Mr. Gertz, I understand now,
13 does for certain broadcasters and other users of
14 copyrighted works in clearing licenses.

15 BY MR. KATZ:

16 Q There are some other rates and terms --
17 terms and conditions about which Mr. Gertz testified
18 that I want to ask for your views on. But in that
19 connection, there is a document, and are you familiar
20 with this document, Mr. Marks?

21 A Yes.

22 Q I am not certain if we have handed this

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1 out to the members of the Panel or not, so let me ask
2 my colleague to do that.

3 ARBITRATOR VON KANN: Your last answer,
4 all these collection agents function as charities? I
5 would have assumed that somehow -- whether you call it
6 a profit or whether you call it a reasonable
7 administrative charge, I assume they get paid, don't
8 they?

9 THE WITNESS: They act as non-profits,
10 essentially. I mean they get paid to cover their
11 costs, whatever their actual costs are. That is how
12 Sound Exchange is operating. That's my understanding
13 of collecting societies for producers, record
14 companies, authors abroad. ASCAP and BMI, I think,
15 are the same way as well.

16 ARBITRATOR VON KANN: They're all break-
17 even operations? In essence, they don't make any
18 money doing this?

19 THE WITNESS: That's right. They take on
20 the liability of unhappy people suing them and
21 complaining and bitching and moaning and so -- just to
22 break even? That doesn't seem plausible to me.

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1 THE WITNESS: Well, they are organizations
2 that their membership is the copyright owners
3 themselves, and they're performing a function for the
4 copyright owners.

5 ARBITRATOR VON KANN: Okay. And there are
6 some membership fees for belonging to those
7 organizations, perhaps.

8 THE WITNESS: Usually it's just the -- I'm
9 not aware of membership fees but the copyright owners
10 understand that whatever costs are incurred in the
11 functions that are performed by that entity that are
12 performed by that entity, would be charged as what's
13 commonly referred to the industry as an administration
14 fee or administrative fee.

15 ARBITRATOR VON KANN: You suggested a
16 vision in which you and Gertz could be designated as
17 agents and copyright owners could pick.

18 THE WITNESS: Right.

19 ARBITRATOR VON KANN: What do we do about
20 the copyright owners that nobody can find to send in
21 their ballot? I'm told that whenever these
22 distributions come alone there are certain numbers of

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1 unknown copyright holders who will not have designated
2 anybody, because they, by definition, have
3 disappeared. How are we going to handle them?

4 THE WITNESS: Well, I assume that Mr.
5 Gertz would agree with this, that he wasn't going to
6 take on the obligation to find the 7,000 or 8,000
7 copyright owners that may have a very small percentage
8 of the actual funds and incur all the costs to do
9 that. And we feel the same way. The bulk of the
10 membership, the bulk of the copyright owners that are
11 members and that are known shouldn't be paying for
12 having to go out and find all the others.

13 So I think the appropriate procedure would
14 be for the Copyright Office to implement what's
15 essentially a registry that requires copyright owners
16 who want to take advantage of the royalties that are
17 part of the statutory license to sign up to do so, and
18 they could -- you could envision going to a web site,
19 for example, where they can click to go to Sound
20 Exchange or click to go to Mr. Gertz' organization and
21 then choose whichever one they think is appropriate.

22 So there would be some obligation on the

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1 copyright owners and the artists to come forward and
2 give the necessary information to make that process of
3 distribution easier, more efficient and less costly.

4 ARBITRATOR VON KANN: So if you don't
5 register, neither you nor Gertz has to send these
6 folks any money, and presumably the services don't
7 have to pay for the use of those sound recordings.

8 THE WITNESS: I think the way it works in
9 the old regulations is that the monies are sent and
10 put into the pool for the remainder. So, for example,
11 we're acting as a sole agent for the preexisting
12 subscription services. All of the money is sent to
13 us, all the royalties. There's a period of time after
14 which if we cannot find the copyright owner, the money
15 goes into the pool for the remaining copyright owners.

16 ARBITRATOR VON KANN: And distributed on
17 sort of a pro rata basis or something?

18 THE WITNESS: Right.

19 ARBITRATOR VON KANN: Okay. Thank you.

20 BY MR. KATZ:

21 Q Mr. Marks, we've just handed out a
22 document to the Panel that we supplied to opposing

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1 counsel yesterday. What is this document?

2 A This is a document that compares the terms
3 that were proposed by the broadcast/webcast group, and
4 I'm just going to refer to them as webcasters to make
5 it easier from here on out. And the purpose of this
6 document was really to isolate or identify the key
7 issues or concepts where there's disagreement as
8 opposed to arguing over specific language in a
9 regulation. We thought it would easier to highlight
10 where the issues are so that the Panel could then make
11 in their decision the appropriation conclusions as to
12 how the issues would be resolved and then could later
13 be implemented as part of a regulation by the
14 Copyright Office, which is how it worked last time.

15 MR. JOSEPH: Excuse me, if I may, we
16 concluded that we had no objection to this document
17 being used as an RIAA demonstrative, clearly
18 understanding that it is not an evidentiary exhibit
19 and that by agreeing to allow it to be used as an RIAA
20 demonstrative, we are not in any way, implicitly or
21 explicitly, adopting the characterizations or the
22 identification of issues thereon. It's simply an RIAA

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1 document for whatever they -- for demonstrative
2 purposes, as they wish to use it.

3 CHAIRMAN VAN LOON: And I see Mr. Katz
4 nodding his head in agreement, and the Panel feels the
5 same way.

6 MR. KATZ: That is exactly how we
7 intended. Let me ask Mr. Marks, then, using this
8 demonstrative if you could highlight some of those key
9 issues and concepts where you perceive there to be
10 disagreement.

11 THE WITNESS: Okay. Sure. Just starting
12 from the top, the first part regards royalty fees.
13 There's obviously a disagreement over what the rate
14 should be, but setting that aside there are some
15 specific issues related to the fees that we thought
16 were important to highlight. So, for example, the
17 definition that the webcasters proposed as compensable
18 performances included essentially an exemption for any
19 performance under 30 seconds. We do not think that
20 that's appropriate, we don't think it's consistent
21 with the marketplace. The deals that we've negotiated
22 generally do not have such a minimum.

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1 And, indeed, in some regard, it's those
2 performances of lesser duration that in some sense
3 have more value, because oftentimes they're a result
4 of using a skip button, and skip functionality is an
5 added functionality or an added benefit for the
6 listeners. So to have -- to offer to listeners a skip
7 function where they can essentially skip between songs
8 and then not count those performances does not seem
9 appropriate to us.

10 It also -- the proposal also seemed
11 inconsistent with some of the other proposals that the
12 webcasters made about being able to measure
13 performances. I mean if you can measure something
14 under 30 seconds, you should be able to measure
15 everything, and that's our understanding, and I think
16 we'll get to that a little bit later.

17 BY MR. KATZ:

18 Q Let me ask you why you disagree with this
19 30-second rule. Have you proposed a shorter period
20 for technological issues for which there would be no
21 charge?

22 A In a few of our licenses, we have, for a

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1 certain period of time, not for the whole license, so
2 we may have included, and I can't remember which
3 agreements they are, but included five or ten seconds
4 for free for a certain period of time in recognition
5 of the technological issues that exist with webcasting
6 people getting bumped off, as opposed, for example, to
7 using a skip button. So, yes, we've recognized that,
8 but those have been limited in both duration, in terms
9 of it not being anything near 30 seconds, and also
10 limited in terms of the time.

11 I should also note that my understanding
12 is that in the marketplace the individual record
13 companies have executed license and received
14 consideration for clips, which are 30 seconds, so to
15 merely --

16 MR. STEINTHAL: I'm going to interpose an
17 objection on this line, because we've had the
18 individual label representatives here. They can talk
19 with their foundation as opposed to this witness
20 testifying beyond the scope of his rebuttal testimony
21 and now with the additional lack of foundation of
22 talking about what other people did rather than things

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1 that he did. So for any number of reasons, I think
2 that answer and any like it should be avoided and
3 stricken.

4 CHAIRMAN VAN LOON: Mr. Katz?

5 MR. KATZ: Well, I think we'll withdraw
6 the last sentence about the other record companies.
7 But let me put one other question to you, Mr. Marks,
8 about the skip button, and that is you testified that
9 that can have additional value for the webcasters and
10 for the users. Is there some loss of promotional
11 value to the record companies when the skip button is
12 imported?

13 MR. STEINTHAL: Same foundation objection.

14 ARBITRATOR VON KANN: What I take this
15 Witness to be giving us at the moment is the RIAA
16 rationale, in essence, for its proposed terms. If the
17 rationale turns out to be unsupported by any evidence
18 of record, they've got a problem. But I mean as I
19 understand it, he's saying, "This is how we reasoned
20 to this proposal and that proposal." I don't see why
21 we shouldn't receive it in that vein, not as
22 substantive evidence of the propositions.

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1 ARBITRATOR GULIN: Well, I guess the
2 question is whether it was discussed in the testimony
3 since this is -- you know, this is the comment period,
4 correct? It's not a question of --

5 ARBITRATOR VON KANN: And he was
6 designated the commentor.

7 ARBITRATOR GULIN: Yes, I agree.

8 THE WITNESS: Yes. If you don't listen to
9 a song, there's obviously not a lot of promotion to
10 it. You have to listen to the song for it to be
11 promotional.

12 BY MR. KATZ:

13 Q What are some of these other key issues or
14 concepts of disagreement that you highlight in this
15 document?

16 A The second one that we've titled
17 incidental performances relates to the webcaster
18 proposal that all non-featured or incidental and
19 ambient performances should be excluded as well. That
20 is not something that we agree with nor think is
21 appropriate nor is supported by the marketplace,
22 generally. I'm not aware of any collective license,

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1 for example, that excludes entirely all non-featured
2 uses. Those are generally regarded as less valuable
3 in terms of the amount that's paid for them, but there
4 is not an entire exclusion for them, and it's not
5 generally supported by our deals either. So we don't
6 think that that is appropriate.

7 The third issue is --

8 ARBITRATOR VON KANN: Question: In your
9 first sentence, is it compensable at the same rate?
10 I thought you -- you did -- you have a separate rate,
11 don't you, for incidental use or am I confused about
12 that?

13 THE WITNESS: I don't believe that we have
14 proposed one yet in the initial, but we will be
15 proposing a separate rate.

16 ARBITRATOR VON KANN: Okay.

17 THE WITNESS: Payment for ephemerals is
18 along the same lines. We believe, as I testified
19 earlier, that there should be a payment for the
20 separate activity of making ephemeral copies, and
21 that's not just because it's a separate activity from
22 the performance but because there is real value to

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1 that. There are entire businesses in fact, such as
2 Akamai and Digital Island, that are predicated, in
3 part, on making additional copies that would
4 essentially be ephemeral copies where they make copies
5 around a the country geographically to make the
6 listener experience more valuable.

7 So, for example, I mean you could have two
8 webcasters, one of which just makes one copy that's
9 subject to the 112(a) exemption and therefore is not
10 subject to the statutory license and another one that
11 makes many, many copies in servers located all around
12 the country so that the listener experience is better
13 for the people tuning into that webcaster. And it
14 would be better, because when you go and listen to the
15 webcaster, you're not getting it from that central
16 server copy, which may be a continent away, but you're
17 getting it from a server that may be only a mile a
18 way.

19 And if you go, for example, to the web
20 sites of Akamai or Digital Island, they talk about how
21 valuable this is in terms of providing a good listener
22 experience for streaming. So there is a real value

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1 associated with the making of these ephemeral copies.
2 It's not merely part of the performance itself.

3 So we propose, and our proposal is based
4 on the deals that we've done at ten percent of the
5 overall fee --

6 BY MR. KATZ:

7 Q What was the point here with respect to
8 royalty calculation?

9 A Royalty calculation was what I alluded to
10 earlier, and that is that if we're going to have a per
11 performance rate, it should be based on actual
12 performances and not some general notion of average
13 listeners or average performances per hour. The way
14 I read the proposal that the webcasters put forward,
15 not only does it allow for this more inaccurate type
16 of reporting but it essentially gives the webcaster an
17 incentive to do all the calculations and then just pay
18 us whichever comes up less. So they might calculate
19 actual performances and come up with 200,000
20 performances but might say, "Well, on average, play
21 this much per hour, and it comes up to 180,000."

22 So that doesn't seem appropriate, and,

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1 again, we think it should be actual performances. And
2 there's nothing in my experience in negotiating in the
3 marketplace that would indicate that there's any
4 problem with reporting actual performances. Every
5 webcaster that we've done a deal with has agreed to do
6 so, generally speaking, and they do it in different
7 ways. There's different ways to report actual
8 performances.

9 We have, however, taken note of the fact
10 that given that we're in a proceeding where the
11 regulations won't be in effect for some time, that
12 there may be some webcasters who haven't, for whatever
13 reason, kept the appropriate logs to make those
14 payments, and therefore would be willing to make a
15 concession that for the introductory period of time
16 that it could be based on an estimation of using 16
17 songs per hour for Internet radio and 12 for
18 simulcasts of AM/FM.

19 The next category, "Other Consideration,"
20 this really falls into two parts. The first is we
21 believe that the regulations should include an
22 obligation to implement security measures to ensure

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1 that the security of the recordings that are being
2 performed by the webcaster are limited as much as
3 possible to avoid the use of whatever technologies
4 exist to capture those streams. That's something that
5 is in every one of our individually licensed
6 agreements. It's something that is extremely
7 important to the industry, generally. There was an
8 entire initiative, I think the Secured Digital Music
9 Initiative, that began because of the security issues,
10 and while it has not dealt yet with streaming, it's an
11 indication of how important that issue is to the
12 companies.

13 Q Mr. Marks, given that there are third
14 parties like Real Networks that create the technology
15 for streaming, do you really need to impose on the
16 webcasters the obligation to employ security measures?

17 A Yes. The webcasters are in the best
18 position to get adequate security measures, because
19 they are the clients of people like Real Networks and
20 Microsoft or whoever else they're getting their
21 streaming software from. If we went to one of those
22 companies and said something about security, it would

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1 not have nearly the same effect that a client of their
2 who's paying them for providing that software to them
3 would have on them.

4 And, therefore, we think, for that reason
5 -- and that's frankly the argument that I used in most
6 of the negotiations that I had over the individual
7 deals, and it was an argument that carried the day in
8 many instances. So we think it's better put on the
9 webcasters, and they are the ones doing the streaming,
10 after all, so they're putting this content out there.

11 The second category are what's termed here
12 promotional considerations, and this refers to the
13 "buy" buttons, the public service announcements and
14 the surveys that we have obtained in our individual
15 deals that was real and valuable consideration in
16 those deals and that we think should be part of the
17 regulations here.

18 On the minimum fee --

19 CHAIRMAN VAN LOON: Before you skip on,
20 could you say a word about what you mean by PSAs? I
21 mean normally that's the non-profit organization, the
22 AG Council --

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1 THE WITNESS: Right.

2 CHAIRMAN VAN LOON: -- who's now all the
3 ads, "I'm an American, I'm an American," with all the
4 different faces and colors. I somehow don't think
5 that's what you have in mind, but maybe I'm
6 misunderstanding.

7 THE WITNESS: No, it actually is. I mean
8 and that's why we limited it to providing the
9 designated agents of the copyright owners as opposed
10 to having to provide any record company that comes
11 along. I mean maybe there would be -- the copyright
12 owners' record companies would be the value of the CD
13 campaign or something, and as a public service
14 announcement would want something like that. I don't
15 know what specifically, thinking forward, but --

16 CHAIRMAN VAN LOON: Public service?

17 (Laughter.)

18 THE WITNESS: Well, I may have been --
19 it's an industry, an industry service announcement, I
20 guess.

21 CHAIRMAN VAN LOON: You mean --

22 THE WITNESS: Maybe not public service.

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1 CHAIRMAN VAN LOON: You mean an ad. You
2 don't mean some sort of non-profit Save the Children
3 or whatever.

4 THE WITNESS: Right. Yes, yes, yes,
5 that's right. That's right. I meant it on an
6 industry basis as opposed to it being necessarily for
7 an individual company or for the public good
8 necessarily.

9 CHAIRMAN VAN LOON: I see.

10 THE WITNESS: Although CDs I think are for
11 the public good. That's another issue, I guess. And
12 I guess it depends on what CD.

13 BY MR. KATZ:

14 Q Is the image of the record industry
15 something which is sometimes a concern to the RIAA?

16 (Laughter.)

17 A You could say that. So there are probably
18 a number of things that would be helpful for us to
19 rectify what is often bad press or
20 mischaracterizations of our positions and our goals.

21 The minimum fee, the point we wanted to
22 make there, setting aside again the numbers, is that

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1 we believe that the fee should be paid as an advance
2 against future royalties at the time that the first
3 monthly payment is due. This is something that we
4 have begun to do in our individual agreements. We
5 didn't do initially but we are doing now. And helps,
6 for example, to offset some of the risk, for example,
7 of companies going out of business. If you wait an
8 entire year, they may be out of business and we don't
9 get the appropriate fee. And, therefore, we believe
10 it should be paid as an advance, and that is something
11 that is not uncommon in the industry, generally, in
12 license agreements.

13 ARBITRATOR VON KANN: What would your
14 position be on separating those two functions? That
15 is, on the one hand, there's a certain minimum fee
16 that you ought to pay to help, I don't know, bear the
17 cost of adding you to the licensing system; on the
18 other hand, in this regime you make your royalty
19 payments in advance, and at the end of the year if
20 you've overpaid, we'll refund you the balance.

21 Now, there could be two different things.
22 You could have a minimum administrative cost -- \$500,

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1 \$1,000, whatever it's going to be -- but you could
2 also say, since there's a track record here of people
3 not being around, this is a regime where you have to
4 make some kind of a payment in advance as a credit on
5 your account. And at the end of the year if you've
6 paid more than you owe, you get a refund.

7 THE WITNESS: Well, I think we wouldn't
8 have a problem with the credit on the account. That's
9 what it's meant to be, as an advance that would be
10 recouped -- or against which future royalties would be
11 recouped. I think, though, that the purpose of a
12 minimum fee is that it's a minimum payment, and
13 therefore you don't get anything back at the end of
14 the year if you haven't used it.

15 ARBITRATOR VON KANN: My point is,
16 conceptually, whether that's desirable or not.

17 THE WITNESS: I guess it's possible. I
18 haven't thought about that.

19 Next is the late fee. We are proposing
20 the same late fee provision that's already established
21 in the regulations for preexisting subscription
22 services. In terms of interest, we are proposing that

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1 the licensees pay interest on all obligations that go
2 back. I think I discussed, and others have discussed,
3 about pointing out that right now it's essentially
4 been an interest free loan of the most valuable assets
5 for a webcaster. They get the recordings, they get to
6 use them, they can take whatever risks are associated
7 with their business and maybe not be in business at
8 some point, and they're doing so -- that there's
9 nothing we can do about, but it certainly seems
10 appropriate that when the royalty obligation becomes
11 due, that they pay some interest on those going back,
12 as you would for any other asset that you were given
13 in the marketplace. And, again, in some cases, by the
14 time the rates are finalized here, there will be some
15 webcasters who will have been using this for three and
16 a half years, and that is a lot of use to have of a
17 very valuable asset without any interest.

18 ARBITRATOR VON KANN: Are you going to be
19 proposing an interest rate --

20 THE WITNESS: Yes.

21 ARBITRATOR VON KANN: -- in your final?
22 Just a footnote, I think we've discussed this, but I

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1 would assume that if you all don't reach agreement on
2 all the terms, this would be one to have some briefing
3 on in your submissions about the propriety of what
4 amounts to a prejudgment interest factor here.

5 MR. KATZ: Well, we're hoping that Mr.
6 Greenspan will do something on our behalf before we
7 have to come up with a rate.

8 ARBITRATOR VON KANN: Okay.

9 THE WITNESS: Okay, Part Two, Terms For
10 Making the Payment of Royalty Fees. I think some of
11 this has already been discussed by other witnesses.
12 We're proposing a monthly payment consistent with the
13 regulations for the preexisting subscription services,
14 and our experience, frankly, in how that's worked,
15 those companies have had no problem giving us data
16 monthly. It's worked well for our systems operations
17 and work flow, and there just doesn't seem to be any
18 compelling reason or any reason at all that that
19 should be moved to quarterly.

20 MR. STEINTHAL: Again, I am going to
21 interpose a narrow foundation objection. We've had
22 two people from Sound Exchange whose job it is to do

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1 this, and now we have Mr. Marks whose job it isn't to
2 do it making these flowery --

3 ARBITRATOR VON KANN: I think he's
4 incorporating their testimony by referencing it. Can
5 I ask you one question about that? In the
6 preexisting, you have three customers who are doing
7 this, I think, or five maybe.

8 THE WITNESS: Three, yes.

9 ARBITRATOR VON KANN: Now we're going to
10 be talking about dozens or maybe more. On this work
11 flow business, what would happen if you used quarterly
12 but staggered the quarters? Somebody's quarter begins
13 -- you know, their reports are due January, somebody
14 else's -- the last three months are due February,
15 somebody else is due -- I mean you could get a nice
16 even flow from a lot of people by just spreading them
17 out.

18 THE WITNESS: I think that Barry Kessler's
19 probably the best person to answer that question,
20 honestly. I mean my point here, just to respond, was
21 I don't think either of those witnesses who've
22 testified earlier are familiar with the regulations.

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1 So I'm pointing out, if nothing else, that these are
2 consistent with the regulations, which I don't think
3 that the other witnesses have done.

4 MR. KATZ: I should note that there was
5 some testimony that Ms. Kessler gave, and we'll
6 explain it in the brief, which may bear on that issue.

7 ARBITRATOR VON KANN: Okay. Go ahead.

8 THE WITNESS: On the timing of payment,
9 the same issue, that the 20 days we propose is
10 consistent with the regulations that govern the other
11 services that are subject to the statutory license.
12 Payment to owners or designated agent, I think this is
13 along the lines of some of what we discussed earlier,
14 and that is ensuring that it's clear that all
15 royalties due are payable to the copyright owners or
16 their agents, and that there's not some deduction
17 that's made by some third party company that's
18 performing a service just for the webcasters.

19 CHAIRMAN VAN LOON: When you say all
20 royalties, though, again, as in response to the
21 earlier question, you're saying, essentially, all
22 royalties minus reasonable expenses necessary to

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1 collect them and distribute them.

2 THE WITNESS: Right. This is just that
3 all royalties are payable to the agents, and then the
4 agents would deduct whatever was appropriate from
5 there.

6 BY MR. KATZ:

7 Q Are you distinguishing, in that regard,
8 between agents for the copyright owners and agents for
9 the webcasters?

10 A Yes, yes. So just to make it clear again,
11 if a webcaster hired a third party to provide a
12 service to them of putting together their logs and
13 sending it along, the payment that comes along with
14 all of that should be the total amount due and not
15 something less.

16 Sufficient information, just pointing out
17 that the statements of account should include the
18 information that's necessary to verify the royalty
19 payment to each designated agent. So as I mentioned
20 earlier, one example of this would be to send a full
21 performance log to each agent and then an invoicing
22 would come back. In other words, you wouldn't provide

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1 just what -- some of the log to one and some of the
2 log to the other. The full log would go.

3 Allocation of royalties to non-members,
4 there are currently regulations that address how
5 royalties would be payable to those who are not
6 members of the --

7 ARBITRATOR VON KANN: Could I stop you on
8 the last one for one second? Maybe this is something
9 that's dealt with here. If you've got two different
10 agents, and most services are not going to know, I
11 guess, necessarily, who's the agent for whom, I could
12 see how they could make a single log and send
13 duplicates to each of you, that's simple enough.

14 THE WITNESS: Right.

15 ARBITRATOR VON KANN: How do they figure
16 what check to cut to each of the two of you if they
17 don't know who's the agent for whom?

18 THE WITNESS: I think in that situation
19 there would have to be some invoicing that was done.
20 So the logs would get sent, and then some period of
21 time later the agent would send an invoice saying,
22 "We've analyzed the logs. Here's what's due."

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1 ARBITRATOR VON KANN: There would have to
2 be at least a little bit of coordination between the
3 two agents --

4 THE WITNESS: Absolutely.

5 ARBITRATOR VON KANN: -- to make sure they
6 don't double bill people.

7 THE WITNESS: Absolutely. And we would
8 fully contemplate working with whoever was the other
9 agent, if there was another agent, to deal with that.

10 The allocation of royalties to non-members
11 deals with a regulation that currently governs the
12 preexisting subscription service proceeding or those
13 regulations that -- the allocation should be done on
14 a performance-by-performance -- equal-weighted basis.
15 So that, for example, if we have 100 members and
16 there's 29 members that have also said, "We want you
17 to distribute for us," and they may or may not join us
18 as an actual member -- we'd have to see how that
19 worked out -- but if there was some distribution to
20 non-members that each agent would be distributing to
21 them on an equally weighted performance and not some
22 distribution methodology that only their members had

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1 decided upon, that's just to protect non-members from
2 having a distribution that affects their royalties
3 that they didn't have a voice in voting on.

4 BY MR. KATZ:

5 Q Mr. Marks, one of the questions that Judge
6 von Kann put to you at the beginning of the
7 examination had to do with the situation in which
8 you've got multiple agents and copyright owners
9 designate one or the other, and that all works fine.
10 But some copyright owners might not designate anybody,
11 and is that a situation in which there's a feeling
12 that perhaps some rules should be adopted for what to
13 do in that situation?

14 A Yes. I think that those are the kinds of
15 rules that would be implemented by the -- in the
16 notice and recordkeeping proceeding in how that would
17 be dealt with. I think that you couldn't really --
18 I'm not sure whether you could force somebody to
19 actually join one of the two organizations, even
20 though you're telling them they have to pick one of
21 the two for distribution purposes. So this is really
22 meant to deal with that latter situation where

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1 somebody says, "Okay. I want you, Sound Exchange, to
2 distribute to me my royalties, but I'm not sure I
3 really want to join you as a member."

4 So there's some protection built in so
5 that if Sound Exchange had adopted a royalty
6 distribution that said all daytime performances are
7 worth ten times all nighttime performances, that
8 distribution methodology wouldn't apply to those non-
9 members; it would only apply to their own members
10 after distributing to the non-members.

11 Part 3, Confidential Information and
12 Statements of Account, we are just proposing again
13 that the definition not be changed. There was some
14 alterations that the webcasters had made in their
15 proposal, and I'm not sure what the basis or reason
16 was for the changes, but we would propose that it
17 remain the same.

18 Same goes for the limitation on the use of
19 confidential information. There's no such limitation
20 that exists presently. The webcasters have proposed
21 one, and we don't think that that is appropriate,
22 because there are other uses. For example, enforcing

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1 the license, reviewing the performance complement,
2 that's something that might be done with the
3 confidential information that would be appropriate,
4 and this would seem to limit that kind of activity
5 unnecessarily.

6 Access to confidential information, I
7 think that there's general agreement, conceptually,
8 but just a couple of language proposals that hopefully
9 we can work out short of handing it over to the Panel.

10 ARBITRATOR GULIN: Going back to
11 allocation of royalties to non-members, I thought I
12 understood that Sound Exchange didn't want to
13 distribute to non-members.

14 THE WITNESS: What we're saying is that at
15 this time we don't want to be designated to do that,
16 because we're not sure of the appropriate -- whether
17 the appropriate procedural mechanisms will be
18 implemented. And we're also, frankly, not sure what
19 the rate would be, and it may not make economic sense
20 for us. But we would envision that this would be a
21 discussion in the notice and recordkeeping provision
22 proceeding about what kinds of -- it gets back to this

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1 registry. If there is a registry that is established
2 that obligates copyright owners, if they want to
3 participate in the royalty pool, to come forward and
4 say, "Here I am, and here's all my tax information and
5 all of the other information you need to distribute,"
6 then we may very well be willing to do that.

7 And I think that the way my testimony read
8 was we weren't, at this time, ready to say, "Okay, go
9 ahead and designate us" without knowing whether those
10 procedures were going to be in place and make it
11 efficient and economically viable for us. We were
12 concerned about having royalties that would go to our
13 members be diminished because of the costs associated
14 with having to go out and find all these thousands of
15 copyright owners.

16 Verification of statements --

17 ARBITRATOR VON KANN: One question on
18 confidential information. Just in a very general way,
19 what is the nature of this confidential information
20 we're talking about? What sort of stuff?

21 THE WITNESS: I think that this covers the
22 reports, the royalty reports that are made. I'm not

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1 sure whether it also covers the data reports or
2 whether that's covered by the notice and recordkeeping
3 provision. I'd have to look at the regulation again
4 to see, but it's that type of -- the information
5 that's associated with making the payments.

6 Verification of statements of account, on
7 the auditing, we believe that the existing regulation
8 should govern and is appropriate. The webcasters'
9 proposal appears to allow auditing only of a three-
10 year period instead of single years within that three-
11 year period. And, frankly, that seems -- I'm not sure
12 that that's sufficient for either party to have to --
13 I mean there only -- there may only be one year. Why
14 be forced to have to actually audit all three years?
15 It should be -- the option should be a year-by-year
16 basis, and that's what in the regulation right now.

17 On the proposal to be obligated to consult
18 before rendering an audit report, that's -- again,
19 there's no provision like that in the current
20 regulations, and we don't believe that there should be
21 such a requirement now.

22 On the costs of verification --

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1 ARBITRATOR VON KANN: Just off the cuff,
2 I don't know anything about this, except that it
3 sounds like why isn't it always a good idea to talk to
4 somebody and see if you've got a very simple thing
5 that can be resolved, as opposed to going through a
6 whole big report process? Maybe there's just a simple
7 misunderstanding.

8 THE WITNESS: I think as a matter of
9 course that may actually happen. I'm not -- I think
10 that there may be situations where you wouldn't -- the
11 auditor might not want to do that. So I think that
12 there's obviously going to be an incentive to limit
13 costs and not engage in more costs. So to the extent
14 that that is a reasonable thing to do under the
15 circumstances, I would expect that it would be done.

16 The costs of verification, their proposal
17 is to increase the five percent variance to a 15
18 percent variance, regarding variance from actuals in
19 the audit in order for the licensee to bear the costs.
20 That is a change in the regulation. It is a change
21 from -- most, if not all, of our agreements have five
22 percent. It's possible that there are one or two that

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1 have ten percent, but I think most have five percent.
2 And this strikes me as something where whatever the
3 number is you kind of give an incentive to somebody to
4 kind of hang out at 12 or 14 percent, and it's just a
5 market incentive. It's not describing any ill will,
6 but it's just not consistent with the current regs or
7 the deals that we've done.

8 The definition of interested parties, the
9 webcasters had proposed eliminating individual
10 copyright owners. We don't think that's appropriate.
11 It's not part of the current regulation. We've got to
12 report to our members. They can audit us as to the
13 performances that are made and the payments, and it
14 certainly doesn't make sense to handcuff the
15 designated agents by now allowing individual copyright
16 owners to see the information.

17 Part 5, largely our disagreements largely
18 track what's in Part 4. On the application of the
19 rules to members, these should only apply to those who
20 collect for non-members. And then I think that we're
21 in agreement on the unknown copyright owners, which
22 may or may not change, depending on the way the system

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1 is implemented with the two agencies, which would be
2 something that's not yet been done and therefore
3 somewhat novel.

4 ARBITRATOR VON KANN: One question here on
5 Part 1. It says that the copyright owner's
6 performance maintain that licensees calculate their
7 royalty payment based upon actual performance.
8 Broadcasters propose the average listening. Maybe
9 I've missed it, but I don't see -- the entire tenor of
10 this document appears to me to assume that royalties
11 will operate, in some fashion or other, on a per
12 performance basis. But you all are also proposing a
13 percentage of revenue basis. I didn't see anything in
14 here that would permit calculating the percentage of
15 revenue.

16 THE WITNESS: I think that those will
17 appear in whatever we propose. If the Panel would
18 like us to propose regulations, those definitions and
19 issues will be addressed there. I think we just
20 didn't highlight it for this document, because the
21 webcasters have not proposed anything on a gross
22 revenue basis, and therefore there's no disagreement

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1 that is necessary to highlight at this point. I think
2 --

3 ARBITRATOR VON KANN: But assume if a
4 percentage of revenue option remains part of your
5 proposal, then there would have to be quite a bit more
6 reporting of data that would permit the determination
7 of revenues and percentages.

8 THE WITNESS: I think that's right. There
9 would have to be -- the statements for the royalties
10 would have to include information on the revenues and
11 the expenses as a minimum and things like that. We'll
12 propose that in the definitions, as appropriate.

13 ARBITRATOR VON KANN: Okay.

14 MR. KATZ: Mr. Marks' testimony here is
15 responsive to other testimony that was given, and that
16 testimony didn't bear on the revenue option, so we
17 didn't go into it.

18 ARBITRATOR VON KANN: Okay. I was just
19 wondering whether it had dropped out.

20 MR. KATZ: If there are no further
21 questions from the Panel, I'm going to shift to a
22 different topic at this point.

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1 CHAIRMAN VAN LOON: Please.

2 BY MR. KATZ:

3 Q Mr. Marks, a witness from Yahoo appeared
4 last week and gave some testimony about Yahoo's
5 perspectives on the negotiation of their license with
6 the RIAA, and I wanted to ask you not so much to
7 respond to the testimony, some of which you weren't
8 permitted to see, but to give your perspectives on the
9 negotiation of the license with Yahoo, as the
10 representative of the RIAA.

11 And let me ask you first how it is that
12 the rate structure that's in the Yahoo license evolved
13 during the course of your negotiations?

14 MR. STEINTHAL: Can I interpose the
15 following objection? We were advised that there were
16 five specific categories. We had this discussion
17 about what Mr. Marks would be permitted to do in
18 rebutting the testimony of any of the licensee
19 witnesses. And it was agreed that it would be limited
20 to Yahoo and that he would -- that the RIAA would
21 provide us notice as to what areas of Mr. Mandelbrot's
22 testimony they would be seeking to have Mr. Marks

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1 rebut, and they've provided us with five categories.
2 So I hope we're going to be limited to those five
3 categories, and we're not just going to be asking
4 questions about overall perspectives on those
5 negotiations, which he already testified to at length
6 when we were here in August -- or September.

7 MR. KATZ: That is my hope and expectation
8 as well.

9 MR. STEINTHAL: Okay.

10 MR. KATZ: Although I would note one
11 problem here is that some of the portions to which Mr.
12 Marks' testimony, I believe, will be viewed as
13 responsive was testimony he was not permitted to read.
14 And so I, therefore, instead of being able to point
15 him to a passage in Mr. Mandelbrot's testimony and ask
16 him to respond to it, I need to ask him a somewhat
17 general question to give his perspective.

18 MR. STEINTHAL: We went through this
19 yesterday.

20 ARBITRATOR VON KANN: That last one was a
21 little too general.

22 MR. STEINTHAL: Yes.

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1 ARBITRATOR VON KANN: That was your direct
2 testimony on Yahoo, which I think we don't want.

3 MR. STEINTHAL: We talked yesterday about
4 mechanism for doing that, which is to raise a topic
5 specifically and ask him if he has any response or
6 whatever to that, rather than a very generic thing.

7 MR. KATZ: I'm really happy to do that.

8 MR. STEINTHAL: Okay.

9 (Whereupon, at 4:18 p.m. the proceedings
10 went into Closed Session.)

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1 BY MR. STEINTHAL:

2 Q I've got to clarify something you said at
3 the beginning because it not only confounded Judge Von
4 Kann, but I don't believe is accurate. This is the
5 issue about these other collecting societies all being
6 nonprofit.

7 First of all, we know of SESAC, and you
8 would agree with me or do you just not know that SESAC
9 is a for profit corporation?

10 A That is true. I had forgot about SESAC.

11 Q So there's that collection of society
12 that's for profit.

13 And with respect to ASCAP and BMI and the
14 others, it's not like they're like NPR are they?

15 (Laughter.)

16 They're not funded publicly.

17 A They're not funded publicly. They're a
18 membership organization that is designed to do,
19 perform a very specific function and to deduct those
20 costs from the royalties that they collect for that
21 function.

22 Q And basically the collecting society goes

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1 out and collects as much as it can and then the
2 officers of the company whether it be ASCAP or BMI,
3 set a budget that includes what some might argue to be
4 rather extravagant expenses for administration,
5 personnel and otherwise, and that's paid for out of
6 the coffers of what's collected, right?

7 A I'm not an expert on ASCAP budgets, but I
8 know that they have a board that's made up of
9 songwriters and artists and publishers and I would
10 assume that they are as the recipients of the
11 royalties approving budgets and viewing -- it's not as
12 if you have officers of a company doing it without the
13 input of the people who are collecting the royalties.

14 Q Are you familiar with the fact that
15 between 15 and 20 percent of the collections of those
16 societies actually go to the administrative expenses
17 and budgets and paying of personnel and everything
18 else?

19 A Yes.

20 Q Let me ask you some questions about your
21 written rebuttal testimony. I'm going to go through
22 it that way instead of through your demonstrative, so

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1 if you could take that out.

2 A I'm not sure I have a copy.

3 (Pause.)

4 Okay.

5 Q And this goes to a point again that Judge
6 Von Kann raised about gross revenues. There wasn't
7 anything in your demonstrative about it, but you do
8 speak to it in your -- actually in your written direct
9 testimony way back when in April as well as here,
10 briefly. And I want to ask a few questions about the
11 definition of gross revenues.

12 A Where is it? I'm sorry.

13 Q In your written rebuttal, it's page 3 to

14 4. A Yes.

15 Q And I could ask you to go back to your
16 written direct, but maybe we can avoid that by just
17 hoping that you'll recollect what you said back then.

18 But the issue -- let's see -- I'm sorry.
19 You testified in your direct case that defining
20 revenues for webcasters can be problematic in many
21 cases. Do you remember that?

22 A Yes.

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1 Q And I think you said it can be problematic
2 particularly where the webcaster offers features other
3 than those related to music?

4 A Yes.

5 Q So let's take an example. Suppose we're
6 dealing with a multimedia website like MTV.com, okay?

7 A Right.

8 Q Are you with me? And let's suppose an
9 advertiser, are you familiar with the concept "run of
10 site" in advertising?

11 A Yes.

12 Q Run of site when an advertiser buys time.
13 It's very analogous to run of schedule in television.
14 You buy time across the whole schedule or across the
15 whole site on the internet, right?

16 A Right.

17 Q Now if I'm an advertiser and I buy, let's
18 say I put a \$1,000 ad campaign run of site for MTV
19 networks for it's on-line properties, I don't know as
20 the advertiser exactly where that \$1,000 is going to
21 be placed, right?

22 A I don't know that. I mean --

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1 Q Well, your understanding if it's run of
2 site as opposed to earmarked or targeted for a
3 specific part of the site. If it's run of site, it's
4 up to MTV to place it, right?

5 A I didn't know that it was up to MTV. I
6 thought that it may be run of site and it's agreed
7 that it's on every part of the site or something. I
8 don't know enough about the agreements to say that
9 it's the site that determines where it goes.

10 Q Well, assume for the sake of argument that
11 when you're dealing with revenue on a run of site
12 basis there is no requirement to place the advertising
13 on any particular part of the website. Would you
14 agree with me that it would be inappropriate to take
15 the full \$1,000 that is paid when it's bought on a run
16 of site basis into the definition of gross revenues
17 for purposes of your webcasting license?

18 MR. KATZ: Excuse me, before the witness
19 answers the question, where is it in the record where
20 this material about the terms of run of site
21 advertising and websites appear?

22 MR. STEINTHAL: I believe at least some of

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1 that -- I think, in fact, Brad Porteus testified a bit
2 about the fact that most of the advertising is not
3 allocated to or bought for MTVi or RadioSonicNet.MR.
4 KATZ: That's a little different from your question.
5 So what's your hypothetical here and what is the basis
6 for it?

7 MR. STEINTHAL: First of all, I don't need
8 a basis in the record for it --

9 MR. KATZ: Yes sir, you do.

10 MR. STEINTHAL: Excuse me, Mr. Katz.

11 MR. KATZ: Or it's not relevant to this
12 proceeding.

13 MR. STEINTHAL: Oh, I see. You can just
14 get up there and propose terms from a witness that has
15 no idea how the advertising is placed or slotted and
16 have it be record evidence and I can't pose a
17 hypothetical question to your witness?

18 MR. KATZ: You can pose a hypothetical
19 question if there's some fair basis for it in the
20 record, Mr. Steintal.

21 MR. STEINTHAL: I believe there is a fair
22 basis --

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1 MR. KATZ: All I'm asking you to do is
2 cite me to it.

3 MR. STEINTHAL: I'll cite the testimony of
4 Mr. Porteus who I believe did testify about the
5 inability to allocate revenues and I think for
6 purposes of the Panel's questions and even your or
7 somebody's board schema of how much can we take and
8 apply if it's a percentage of revenue license and he
9 said it's got to be under 10 percent and we would just
10 that number for sake of argument because it is
11 impossible, as he testified to allocate revenues on a
12 multimedia site like MTV to the radio property. So
13 I'm quite confident that that is in the record.

14 MR. KATZ: But what's your question? It
15 wasn't the predicate of the question you just asked.
16 It's a different question.

17 MR. STEINTHAL: I'll do it again.

18 BY MR. STEINTHAL:

19 Q Assume for the sake of argument, Mr.
20 Marks, that advertising is placed on a run of site
21 basis in a manner where it is not specified as to how
22 much of that revenue, that ad revenue, is allocated to

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1 the radio product of a multimedia site.

2 Are you with me so far?

3 A Yes.

4 Q In that situation, would you agree that it
5 would be inappropriate to take the entire amount of
6 revenue?

7 A Not necessarily.

8 Q Under what rationale could you offer that
9 a -- if we're doing \$1,000 as our example, that \$1,000
10 ad placed on a run of site basis, that includes
11 webpages having nothing to do with RadioSonicNet,
12 present example, or any of the other radio properties
13 that are subject to this proceeding, under what
14 rationale can you take the full amount of revenue and
15 put it into your gross revenue definition?

16 A If music is driving people to the site and
17 the visitors would not be going but for the music,
18 then I think it would be appropriate to take all of
19 the thousand dollars.

20 Q Okay. This is very interesting. So that
21 if MTV, let's assume that MTV's got a site that's
22 streaming music videos, okay? You would agree with

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1 me, would you not, that streaming music videos is not
2 part of this case?

3 A Yes.

4 Q MTV doesn't have to pay a digital sound
5 recording performance right for the streaming of music
6 videos, right?

7 A Right.

8 Q Okay, so now advertiser places \$1,000 ad
9 and you don't know for sure how much of that \$1,000
10 goes to parts of the site that are streaming music
11 videos, parts of the site that are interviews of MTV
12 on-air personalities and how much is attributable to
13 the RadioSonicNet service that actually streams sound
14 recordings pursuant to statutory license and under
15 that assumption you think it can fairly be stated that
16 all \$1,000 can go into your gross revenue definition?

17 A No, I think all I said that was under
18 certain circumstances, it would be appropriate to take
19 all the \$1,000. I think this is part of the
20 difficulty in gross revenue licenses.

21 Q Let's do it piece by piece. Would you
22 agree that unless it can be demonstrated that a

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1 portion of that \$1,000 is attributable to the product,
2 that is streaming music under the compulsory license,
3 it would be inappropriate to put it in the gross
4 revenue definition.

5 A I think the burden runs the other way,
6 frankly.

7 Q Putting aside burden, would you agree as
8 a matter of principle that the only fair allocation of
9 that \$1,000 run of site ad for purposes of the RIAA's
10 gross revenue license would be that portion of the
11 \$1,000 that's attributable to the part of the service
12 that's streaming sound recordings under the compulsory
13 license?

14 A I think in an individual negotiation, if
15 I were negotiating with a webcaster or some site that
16 had a number of things going on, and they could
17 demonstrate to my committee's satisfaction that only
18 a portion should be attributed in that situation we
19 might be able to work out a formula to cover it.

20 Q So you're the arbiter?

21 A I'm not saying I'm the arbiter. I'm
22 saying in an individual negotiation that's something

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1 that could be worked out.

2 Q Let's talk about it as a matter of just
3 fairness and common sense for a minute, okay?

4 And I said putting aside the issue of
5 whose burden it may be, would you agree that in a
6 situation where advertisers are paying run of site for
7 a multimedia site where the radio product under the
8 DMCA is only a small portion of it, wouldn't you agree
9 that the only fair allocation of revenues would be
10 those revenues that are attributable to the radio
11 product and not the revenues that are attributable to
12 the rest of the site?

13 A I think that's too simplistic a formula
14 because you could have a situation where AOL, for
15 example, runs no ads where they offer the radio, but
16 they run all -- they sell all of the advertising which
17 is based in part of the people coming to the site
18 because of the music on other parts of the site and
19 then we would be ending up getting zero.

20 Q Put aside the simplistic part of it for a
21 minute. In theory, wouldn't you agree that it is only
22 fair and reasonable assuming one could make an

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1 allocation of that run of site advertising, among the
2 various parts of the website to include in your
3 revenue base that which is attributable to the product
4 that you're licensing?

5 A I don't think it's as easy as making an
6 allocation. That's where I'm getting caught up
7 because it depends -- if what you're saying is a third
8 goes to each part because a third of the people are
9 listening and -- or visiting a site because of each of
10 the three parts, possibly, yes. But I think it's much
11 more difficult a proposition than that in most cases.

12 Q Maybe we can agree on this because I'm
13 really -- I just want to establish a couple of small
14 things that honestly I think we can agree on.

15 You would agree with me wouldn't you that
16 it would be inappropriate for the entire run of site
17 revenue to go into your gross revenue definition in a
18 situation where run of site ads are placed for the
19 whole website, right?

20 A If it was clear that all of the people
21 that were coming to the site went, for example, to the
22 radio part first and were visiting -- only went to the

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1 site but just because they went for the radio and then
2 happened to while they were listening to radio click
3 on another portion of the site, I don't think that the
4 ads on that other portion of the site should
5 necessarily be excluded.

6 Q It's a big if, but -- take it the other
7 way. If all the traffic is to the non-radio or let's
8 take it differently. Ninety percent of the traffic
9 when it first comes on the website is to the non-radio
10 product, would you agree that 90 percent of the
11 revenue should be excluded from your revenue base?

12 A It may be. Again, this is something that
13 we'd have to discuss. It's just more easily to do
14 that in any individual discussion about what the site
15 is about and what the evidence is that that's what
16 people are visiting and things like that.

17 Q The Panel doesn't have that luxury. All
18 I want to do is get some ground rules here on fairness
19 and then maybe if we establish what's fair and not
20 fair or at least some parameters, maybe between now
21 and the time the Panel has to decide, we can actually
22 reach some agreement on definitions of gross revenues.

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1 Let me ask you this again --

2 ARBITRATOR VON KANN: Let me make sure I
3 have one thing clear. I think I'm hearing him and
4 you're not. And so let me try a formulation and see
5 -- I think what you're saying is that including some
6 revenue chunk in the royalty calculation ought to be
7 because the use of sound recordings has in some way
8 generated that revenue, but it might not be as simple
9 as saying did the ad run on the web service or did it
10 run over here. There may be cases in which the use of
11 sound recordings has really brought about that revenue
12 even though the ad appeared in a different part of the
13 service.

14 I think you're sort of in agreement with
15 Mr. Steinthal's general concept that there ought to be
16 some sort of cause and effect. Our sound recordings
17 should have, in some way, contributed to that revenue
18 being there. It may not necessarily just because the
19 ad appeared on the service. It might be because our
20 ads brought all the people to the site, if that could
21 be shown.

22 THE WITNESS: I think that's generally

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1 right. I think that's one issue that you have to
2 overcome and I think that the other issue is the
3 example I gave, not to pick on AOL, but the situation
4 where you have the radio going on one part and you
5 just run the ads. People buy ads because people are
6 coming to the site generally because of the radio and
7 they just place the ads somewhere else. They don't
8 put them in the music. They don't run banner ads.
9 Maybe they just have a player, so there's no banner
10 ads. And it's very easy to circumvent in that
11 situation. We could get 100 percent of royalties, but
12 if they're not running any ads or doing any e-commerce
13 or whatever the basis is, through that radio portion,
14 we're not going to see a penny, even though people are
15 coming to the site because of the radio or the radio
16 itself is generating revenue on other parts of the
17 site.

18 BY MR. STEINTHAL:

19 Q So I guess hearing that it would seem to
20 me that it would be a correct statement that your
21 position is that if the amount of run of site revenues
22 were fairly attributed so that those revenues

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1 attributable to the use of sound recordings under the
2 DMCA by a given service were attributed in that
3 fashion, that would be acceptable to the RIAA?

4 A Attributed --

5 Q I don't think we're going to agree on the
6 definition of attributed today. I don't want to go
7 further than that. I just want to limit ourselves in
8 concept to the following: would you agree that of the
9 total run of site revenues that a website would
10 collect that the portion that properly should go into
11 the definition of gross revenues for the DMCA
12 component of the service would be the portion fairly
13 attributable to the use of sound recordings?

14 A I think actually our rate proposal uses
15 the words "attributed."

16 Q The bigger problem would be how to define
17 "fairly attributable", but I'll leave that for another
18 time.

19 A Okay.

20 Q Let's put aside run of site revenues and
21 talk about other kinds of revenues for a minute. Are
22 you familiar with the definition of gross revenues

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1 that are subject to fee in the radio ASCAP BMI
2 licenses and the TV licenses that have been under a
3 percentage of revenue formula in the television --

4 A Generally, but I'm not an expert on it.

5 Q Because I know we saw some of your e-mails
6 to that effect back and forth to some licensees
7 concerning certain definitional issues where you refer
8 to the ASCAP BMI licenses, do you remember that?

9 A I think there was just the issue of the ad
10 deduction and pointing out that we gave a greater ad
11 deduction.

12 Q Now are you familiar with the fact that
13 under the ASCAP BMI revenue definitions if a radio
14 station makes money from selling WPLJ hats or WPLJ
15 t-shirts or other merchandise like that, that revenue
16 doesn't come into the definition of revenues under
17 which the fee is paid?

18 A You mean for their -- which license? Are
19 you talking about the broadcast license?

20 Q Broadcast radio.

21 A I believe that's right.

22 Q Would you agree with the same notion here

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1 that if a website generates merchandise for revenues
2 from the sale of call it RadioSonicNet hats or Spinner
3 shirts, that shouldn't be part of the revenue base
4 here?

5 A No, it's included in every one of our, the
6 deals we've done in gross revenues.

7 Q The fact that you've done it, with all due
8 respect, doesn't mean that it's fair and reasonable
9 for everybody under a statutory license --

10 A You just asked me what I thought was fair
11 and I think what we negotiated was fair is all I'm
12 saying.

13 Q So since you negotiated with your
14 licensees that are paying under a gross revenue basis
15 to include that kind of merchandising revenues, do you
16 think it should be in the statutory license even
17 though that same sort of revenue doesn't go into the
18 revenue base for the more historic percentage of
19 revenue licenses in broadcast radio with ASCAP and
20 BMI?

21 A I think what ASCAP and BMI want to cover
22 for the royalties they get for the use of their

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1 copyrighted works is their decision. That doesn't
2 bear on what our members think is appropriate for the
3 use of their copyrighted work.

4 Q And tell me, sir, what the direct
5 relationship is between RadioSonicNet selling a hat
6 and the use of your sound recording?

7 A I think it's the same issue. If people
8 are coming to the site because of the music and
9 there's ancillary income because of that, there is a
10 basis for having that included in the revenues that
11 are the base for the royalty rate.

12 Q Well, you don't really know why they're
13 going to the site, do you, on a multimedia site, for
14 example?

15 A Again, it depends on the site, that's
16 right. It's clearer with other sites than it is with
17 -- it's clearer with some sites than others.

18 Q Is your testimony that gross revenues
19 should be defined so that it includes merchandising
20 revenue on multi-media sites, notwithstanding the lack
21 of any direct evidence as to why the individual went
22 to the site in the first place?

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1 A I think it should be defined in a way that
2 it captures what was attributable to the music.

3 Q What about when companies sell technical
4 services? Suppose, as the testimony is in this case,
5 there's some webcasters that have divisions that
6 create services that they license to third parties,
7 whether it be webcasting services or software
8 services. What's your position on that? All those
9 revenues come into --

10 A I think the answer is no, but I just want
11 to make sure I understand what -- they have a separate
12 piece of software or something that they offer to
13 people that are not general website users, but to
14 other sites or something like that? I think we have
15 excluded those in our deals.

16 Q Is it a fair statement to get pass gross
17 revenues that the standard you think should be applied
18 is whether or not the revenue is directly attributable
19 to the use of music on the site?

20 A Yes. We're not seeking to get revenue
21 that's not attributable to the music on the site.

22 Q Okay. Let's take a look now in your

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1 written testimony on page 4 --

2 CHAIRMAN VAN LOON: Are you going to pass
3 on to another subject?

4 MR. STEINTHAL: Yes.

5 CHAIRMAN VAN LOON: Can I just ask
6 briefly, we're of course charged with willing
7 buyer/willing seller in the competitive market and a
8 lot of economists have said to us that that should be
9 a market where there's not a monopoly power, so we're
10 supposed to try to figure out what that means.

11 Is it your position then that we set the
12 definitions, if we're seeking to set a definition of
13 fair gross revenues, that basically anything that was
14 fair that RIAA could negotiate with regard to what's
15 in or out gross revenue definitions that we should
16 accept that as sort of the definition of fair in the
17 marketplace?

18 THE WITNESS: I think that's right. All
19 I can tell you is in my experience we were anything
20 but a monopoly. We were a forced seller and all of
21 the negotiations I had the person could get up and
22 walk away and we had no leverage to say sorry, if you

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1 walk away, you can't use our content. And I know
2 we've talked about this in the past, but I can just
3 tell you what my experience was and it was certainly
4 not as a willing seller. It was as a forced seller.

5 CHAIRMAN VAN LOON: Was there much back
6 and forth over, for example, the definition of gross
7 revenues?

8 THE WITNESS: Yes, yes in certain of the
9 negotiations, yes.

10 CHAIRMAN VAN LOON: Was it your experience
11 in most of these definitions, I'm sorry, in most of
12 these negotiations that there were an awful lot of
13 issues on the table?

14 THE WITNESS: Yes, the issue that just
15 came up about the technical services or the software,
16 that was an issue that came up at least in one
17 negotiation and we carved it out of the definition
18 based on what we thought were the meritorious
19 arguments that were being made by the company that we
20 were negotiating with.

21 MR. STEINTHAL: Your Honor, rather than
22 take the witness through it all, we have all the

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1 witness binders and we will be able, in our post trial
2 briefing, to show you just how often there was a
3 negotiation over the definition of gross revenues.

4 ARBITRATOR VON KANN: You will argue from
5 the record in great length.

6 MR. STEINTHAL: I could go one by one
7 through the license --

8 ARBITRATOR VON KANN: Not now.

9 MR. STEINTHAL: And show you how few, but
10 we'll get to that.

11 BY MR. STEINTHAL:

12 Q In paragraph b on page 4 in your written
13 testimony, this is subject to the payment terms and
14 you already have gone on in your direct testimony that
15 you believe that payments should be made monthly and
16 were at quarterly.

17 Let me ask you this question, are you
18 aware of what the RIAA and its members seek in terms
19 like this when the shoe is on the other foot, when
20 they are the licensee rather than the licensor?

21 A If you're referring to the mechanical
22 license, I know that that is quarterly, but I don't

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1 know the reasons it's quarterly, so I can't tell you
2 why that should be different. All I can tell you is
3 that in this license, monthly is what we've
4 negotiated. Monthly is what the governing regulation
5 is and monthly is what's been working pursuant to that
6 regulation.

7 Q We have as a standing answer that as you
8 just said that if you negotiated it, you think that's
9 the right way it should be, but I'm going to ask you
10 to look at the following document or documents, two
11 documents. One is from your website, SX 35 and SX 36
12 should be put on a restricted basis. I don't know if
13 it's been marked that way, but if it hasn't, we need
14 to do that.

15 (The documents were marked for
16 identification as SERV Rebuttal
17 Exhibit No. 35 and 36.)

18 CHAIRMAN VAN LOON: That will be in closed
19 session?

20 MR. STEINTHAL: Everything since Yahoo!
21 can be public up until the discussion of Service
22 Rebuttal Exhibit 36 because I'm not sure how public

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1 that document is.

2 CHAIRMAN VAN LOON: Is that the one we're
3 getting now?

4 MR. STEINTHAL: You're getting 35 which is
5 a public document and 36 which may not be.

6 35 is the restricted document and 36 is
7 the public document.

8 CHAIRMAN VAN LOON: When we say that
9 concludes Yahoo! and now we want to talk about terms
10 and conditions and the first question was whether
11 SESAC was a for profit organization and the other two
12 can be in public session.

13 (Pause.)

14 BY MR. STEINTHAL:

15 Q Looking at these two exhibits, let's get
16 a little context for it. Are you aware, are you not,
17 that within the last couple of weeks following a
18 period of several months the RIAA and the NMPA reached
19 an agreement that covers the licensing of mechanical
20 rights associated with on demand streaming services
21 and limited download services which are owned in whole
22 or part by the record label?

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1 A Yes.

2 Q And does Exhibit 36, the press release, is
3 that a press release that was put by the RIAA and
4 available on its website about the agreement that was
5 reached between the NMPA and RIAA on that subject?

6 A Yes.

7 Q And is Exhibit 35 the agreement itself?

8 A It appears to be.

9 Q Do you know whether that's a public
10 document at this point or not?

11 A I honestly don't.

12 Q Okay, either do I.

13 MR. KATZ: It is not.

14 MR. STEINTHAL: Okay, so let's just keep
15 it on the restricted record.

16 (Whereupon, the proceedings went into
17 Closed Session.)

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1 MR. STEINTHAL: In sequence, I take it,
2 we're going to do Mr. Junkala first and then we'll
3 finish Mr. Marks and then go to Mr. Wildman?

4 CHAIRMAN VAN LOON: That would seem to
5 make the most sense unless people have a strong
6 preference for something else.

7 MR. KATZ: Makes sense to us.

8 CHAIRMAN VAN LOON: Okay, let's do that.
9 Mr. Garrett?

10 MR. GARRETT: Thank you. The Panel had
11 requested that we provide certain information and a
12 request was made in an order of October 2, 2001. We
13 had prepared a response and shared it with the other
14 side and they advised us yesterday that they had no
15 changes to what it was that we had proposed, so at
16 this point I would simply hand out what we were
17 responding to the Panel's October 2, 2001 order.

18 MR. STEINTHAL: I'm sorry, is this --

19 MR. GARRETT: There were a couple of
20 requests, one was with respect to Artist Direct, a
21 second one was a request for a copy of Warner Music
22 Group, MTV agreement and the third was a description

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1 of the limited interactivity in Clickradio.

2 ARBITRATOR GULIN: And you will file with
3 the Library?

4 MR. GARRETT: Yes, we will.

5 MR. STEINTHAL: Just for the record, this
6 was shared with us. We didn't believe it appropriate
7 for us to negotiate over it since it was a request to
8 the RIAA. We would probably articulate the
9 interactivity of Clickradio a little bit differently,
10 but feel that it was a request to the RIAA to respond
11 and did not either negotiate changes in that
12 description or indicate the changes that we would deem
13 appropriate. If the Panel would like us to do that,
14 we will. It's not a big issue. We would just
15 describe it somewhat differently.

16 MR. GARRETT: Frankly, and that was the
17 reason we shared it. We could have filed this letter
18 over a week ago when we first submitted it to them.
19 The whole purpose of submitting it to them and so that
20 we had an agreement, a consensus on how to describe
21 that limited interactivity. We thought that's what
22 the Panel asked us to do since there wasn't a witness

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1 coming in to describe that.

2 This is the first that I'm hearing that
3 they had any questions about it.

4 CHAIRMAN VAN LOON: Let's take a look at
5 it.

6 MR. STEINTHAL: We had an e-mail exchange
7 yesterday through Mr. Cohen in New York indicating
8 pretty much what I just said, that there was no --
9 this was a request to the RIAA? I'm not suggesting
10 that there's a world of difference. It's just that
11 it's not our words. It's not the way we would have
12 chosen to describe the functionality.

13 CHAIRMAN VAN LOON: But it's on Arnold &
14 Porter letterhead, so we could infer that.

15 MR. STEINTHAL: Okay.

16 (Pause.)

17 CHAIRMAN VAN LOON: What we'd like to do,
18 Mr. Steintal, is give you an opportunity to review
19 this further. If you think there's a material matter
20 that needs to be characterized differently, if you
21 would give us that in writing within a week from
22 today.

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1 MR. STEINTHAL: Not a problem. And I'm
2 not promising we will find there to be a material
3 difference.

4 CHAIRMAN VAN LOON: And that's the end of
5 the month, Halloween. We look forward to it.

6 MR. STEINTHAL: That will be an easier
7 process than stipulating to the terms and conditions,
8 I assure you.

9 ARBITRATOR VON KANN: If you guys were
10 making a lot of progress, we might be persuaded to
11 give you a little more time.

12 MR. JOSEPH: I felt there was that
13 possibility.

14 ARBITRATOR VON KANN: It's a possibility.

15 MR. GARRETT: How about a year?

16 (Laughter.)

17 ARBITRATOR VON KANN: Not that much.

18 CHAIRMAN VAN LOON: Let's stand adjourned
19 until 9 o'clock tomorrow morning.

20 (Whereupon, at 6:25 p.m., the hearing
21 recessed, to reconvene Thursday, October 25, 2001 at
22 9:00 a.m.)

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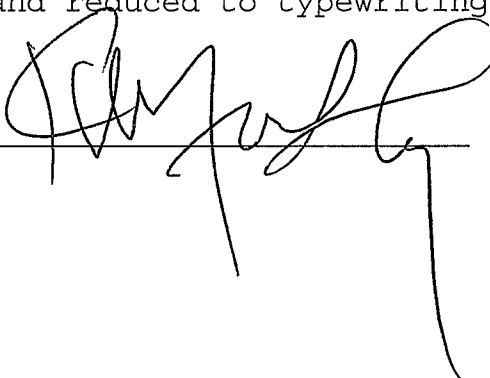
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Date: October 24, 2001

Place: Washington, D.C.

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